

How to get great rates (and not get beat up)

The caller ID said ‘Kansas City Kansan,’ an on-line newspaper. I said, “Hello, this is Carl Brown, Carl Brown Consulting...” It was Nick Sloan, a staff writer. Nick had read in the Bonner Springs, Kansas newspaper, *The Chieftain* that the Council recently voted to increase water and sewer rates. I think he used the term, ‘RATE HIKE.’ Nick read that I was the city’s rate analyst so he wanted some quotes from me for an article he was writing for his paper. Nick and I had a nice conversation, he got his quotes and I went back to the rate analysis I was working on at the time.

Nick’s article, and the *Bonner Springs Chieftain* article, both read very well. They even sounded complimentary.

The city and its management were portrayed as they really are – sharp managers planning for the future of the systems and their ratepayers. A ratepayer from Bonner Springs who read those articles would think, ‘Our systems are doing

OK right now. But, they’re headed for financial failure pretty soon and it won’t take much of a rate increase to keep them in good shape. Hmmm...’

Your hometown newspaper writer should be writing that kind of article about you, or your system and or your system’s finances every year. That’s right. You should be adjusting your rates every year – incrementally. Then,

you should do a thorough analysis and rate and fee restructuring every few years to get, and keep your rates, on track.

When was the last time your local paper ran an article about rate increases that your council or board passed? Last month? Last

well. Now, they didn’t exactly agree on what that would look like – we all have a point of view. But after careful consideration, the Bonner Springs City Council adjusted rates appropriately.

Bonner Springs’ water and sewer systems are well managed

Give newspaper writers good, hard facts to report and they will. Don’t, and they are left to interview ratepayers worried about how they are going to pay their water bill because they didn’t get the facts either.

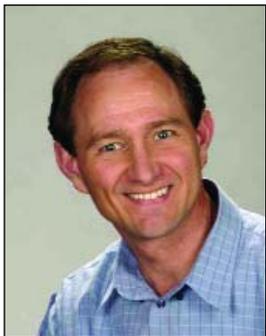
year? Ten years ago? Did the article pass along solid, factual information about the increases and the financial condition of the system? Or, did it read more like a smear of your management? Give newspaper writers good, hard facts to report and they will. Don’t, and they are left to interview ratepayers worried about how they are going to pay their water bill because they didn’t get the facts either. Adjusting rates in a public system is a political decision. But that decision should be based on the facts.

The articles brought back for me these facts. The Bonner Springs staff and Council were great to work with. They all wanted to do the right thing – run solid water and sewer systems and fund them

and funded like most others. You could expect your rate adjustment needs to be something like theirs. Bonner Springs’ rate studies showed that the water rates needed to go up an average of 33

percent. (Most of my clients end up raising rates 20 to 45 percent with the range going from six percent to 330 percent.) The affordability index of the new rates would be 0.65 percent (see sidebar on the next page for a description of

financial capacity indicators). The sewer rates needed to go up an average of only 11 percent. The affordability index of the new sewer rates would be 0.58 percent. Without an increase the systems would be deep in the hole in 10 years. With the increases, reserves will be about \$3.7 million in 10 years and the systems will have the funding to operate well and do



Carl Brown
Carl Brown Consulting, LLC



What does it all mean?

Rate analysis or user charge analysis – A thorough examination of a system's use, expected growth (or decline) in use, rates, current and future incomes, current and future operating costs, equipment replacement needs, capital improvement needs, and more. This examination determines if rates and fees are now, and will in the future be, adequate and fair to customers. If they are not adequate and fair, the analysis will suggest how to make them so.

Operating ratio – A measure of how easy it is for a system to pay its operating costs. At 1.0, incomes and reserves are just great enough to pay operating costs, not including payments on debt. Most small to medium sized water and sewer systems should achieve an operating ratio of 1.25 or greater. Chart 10 shows that Bonner Springs' operating ratio started at about break even last year, it is headed to negative numbers soon under the current rates but it will stabilize at a strong position under the new rates.

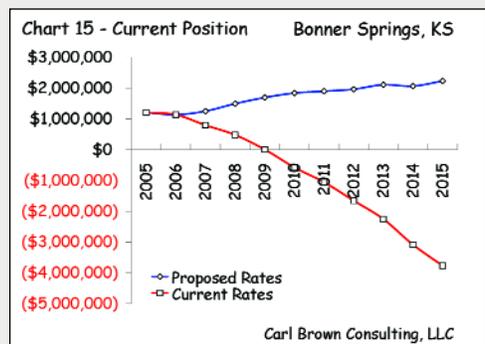
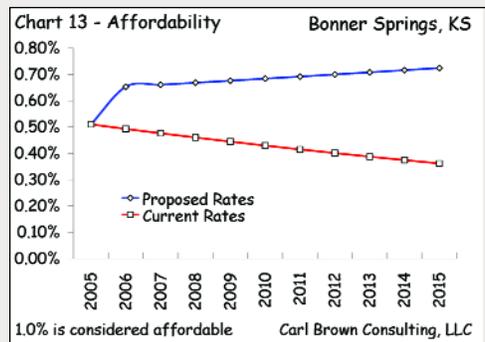
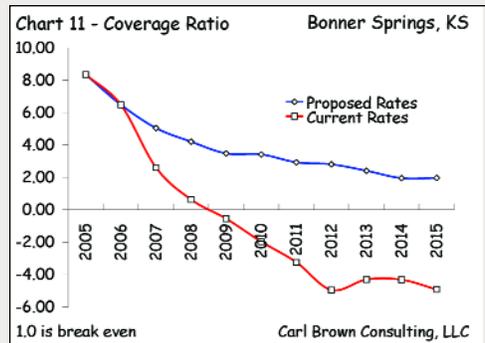
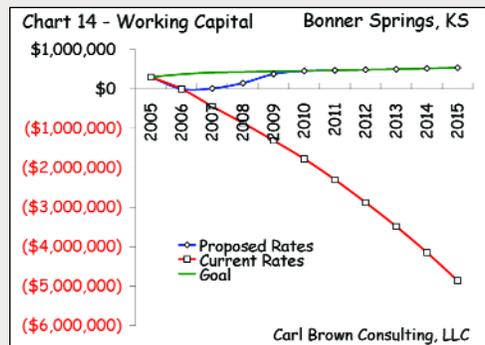
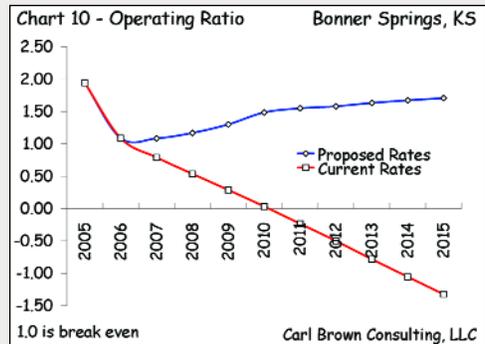
Working capital – Unrestricted reserves plus the funds left in the operating account after all current bills have been paid. Most systems try to break even when they actually should have working capital of about 35 percent. Chart 14 shows that Bonner Springs' working capital will drop like a rock under the current rates but recover in a couple of years under the new rates.

Coverage ratio – A measure of how easy it is for a system to pay its debts. At 1.0, incomes and reserves available to pay debt are just great enough to pay the debt. Most small to medium sized water and sewer systems should achieve a coverage ratio of 1.25 or greater. Chart 11 shows that under the current rates Bonner Springs' coverage ratio will go negative soon but ease down to a strong 2.0 in 10 years under the new rates.

Affordability index – In water and sewer systems, a measure of how easy it is for a residential user of 5,000 gallons per month to pay their water or sewer bill. An affordability index of 1.0 means the bill consumes one percent of the median monthly household income. An affordability index of 1.0 or less is considered affordable. Most grant programs now target an affordability index of 2.0 or greater. Chart 13 shows that Bonner Springs' affordability index will change very little following the rate increases.

Current position – Subtract all current financial obligations from all reserves and incomes. Do not include values for hard assets such as treatment plants and lines or principal amounts owed for such assets. Current position measures overall financial fitness. Chart 15 shows that Bonner Springs' financial fitness is strong and improving under the new rates but falling fast under the current rates.

Annual budgeting – An examination of incomes and expenses with the goal of producing a desired net revenue at the end of the year being budgeted. To obtain a financial statement template that incorporates operating, coverage and affordability indices, visit <http://carlbrownconsulting.com/Tools.htm> and click the 'financial statement template' link. This is a Microsoft Excel spreadsheet and it will do the math of your financial statements, including calculating these indices, for you.



needed capital improvements in the meantime. Quite a turn around for \$10 a month. Staff and I presented the rate and fee increase 'case.' The Council considered the facts and voted for the increases.

How should you present your rate increase 'case'? Start by learning and appreciating these facts:

1. While a spreadsheet program or even a printed workbook can help you estimate your rate and revenue needs, it will not analyze your rates for you.
2. Every system needs to estimate its rate and revenue needs every year. This is basic budgeting. But, it is not rate analysis.
3. Every system needs to analyze its needs for revenues, rate and fee adjustments, debt service and rate restructuring every few years or whenever something big happened (you went broke) or something big

is getting ready to happen (you need to build a new water tower in three years). This analysis is a giant word math problem, with lots of political and social studies and business

system to tens of thousands of dollars for larger systems.

Next, where can you learn how to do rate analysis? Or, where can you learn how to get someone else to do it for you?

The key is, you or someone else must start the rate analysis process and then keep it going. This is an ongoing task like annual budgeting, reading meters and pulling water samples.

planning thrown in. There is no substitute for either you doing lots of learning and lots of work, or hiring a specialist who has already learned how to do this work.

4. Time is money. If you postpone increasing rates, every month that goes by costs you in terms of uncollected rate revenues. This monthly cost ranges from a few thousand dollars for a small

Second question first, visit <http://carlbrownconsulting.com/HowtogetaRateStudy.htm> for a step-by-step process. This site includes document templates that will make the process easier and surer for you.

First question, know that do-it-yourself rate setting will take lots of patience, work and mistake-making. Some of those mistakes could be costly to the tune of tens of thousands of dollars for a small system and more for larger systems, but don't let that stop you. Learn to eliminate many of those errors and make your time as productive as possible by attending training like the workshops discussed below.

The key is, you or someone else must start the rate analysis process and then keep it going. This is an ongoing task like annual budgeting, reading meters and pulling water samples. But, proper rate setting is also different from all other tasks in this way. If you don't do this task right, someday you won't be doing the other tasks at all.

If that happens and you are an optimist, you can enjoy this silver lining. You won't have to worry about a newspaper reporter interviewing you for an article called 'RATE HIKE.'

Rate analysis training scheduled for 2007

User charge analysis is a technique for determining if rates are adequate and fair today and how to keep them so in the future. Water and wastewater utility managers and decision-makers need to analyze rates regularly, or have a specialist do that for them.

The Kansas Rural Water Association wants all Kansas water and wastewater systems to be well-funded. Increasing rates will either be the THE most difficult thing a board or council will do, or it will be close to the top of that list. However, with a solid rate analysis, adjusting rates goes smoothly and incremental increases in subsequent years will be a snap.

KRWA will sponsor workshops this summer to train on rate analysis and other financial issues. These have tentatively been scheduled at:

1. June 5, Manhattan *Check the KRWA Web site for further updates:*
2. June 6, Wichita www.krwa.net/training
3. June 7, Chanute
4. August, Management Conference, Topeka

Here's the bottom line. If the system's bottom line is not strong, then the system's future is at risk. KRWA wants to help all systems stay strong.

Water, sewer rates to increase; average bill up \$10 a month

By Jesse Truesdale, Reporter, *Bonner Springs Chieftain*
Wednesday, December 20, 2006

The Bonner Springs City Council voted to bite the bullet Monday night and hike water rates by about 33 percent, or \$8.43 a month for the average residential ratepayer.

As drastic as the increase may sound, at \$9 for a minimum charge and \$4.20 per 1,000 gallons for less than 70,000 gallons a month, Bonner Springs' water rates will still be lower than those of nearby systems like Basehor and the Kansas City, Kan., Board of Public Utilities, which charge \$5.63 and \$6.64 per thousand gallons, respectively.

The rate increase will mean an extra \$8.43 per month for the average residential customer, who uses about 5,900 gallons each month. The rate will increase by much smaller increments after the first year, at about 4.5 percent yearly.

The impact fees – money charged to tap into the system – for both utilities were also raised.

A short workshop session had been held before the meeting, after a much longer one and a crash course on rate setting last week, to discuss the findings of a study by Carl Brown, of Carl Brown Consulting, LLC.

calculations, the city would be in the hole \$7,841,411 in 10 years.

But, with the water rate increase the Council approved, Brown said the city would be able to pay for needed improvements and equipment replacement, and build

Without the rate adjustments, by Brown's calculations, the city would be unable to pay for planned capital improvements, needed equipment replacement, or to accommodate growth.

Brown was hired by the city to look at the financial health of its water and sewer services and to determine what rates should be set at to ensure the continued solvency of both utilities for the city.

Without the rate adjustments, by Brown's calculations, the city would be unable to pay for planned capital improvements, needed equipment replacement, or to accommodate growth. Without the water rate increases, according to Brown's

up a capital of \$2,174,535, which could be used as security against unforeseen costs.

The Council approved the water rate increase by a vote of 5-3, with Council members Scheidt, Amber Sechrist, and Jerry Jarrett dissenting.

The Council approved the sewer rate increase by a vote of 7-1, with Council member Wendy Scheidt dissenting.

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