

BUILDING A WORLD OF DIFFERENCE

22 July 2011

TRENDS / ISSUES IN WASTEWATER RATE SETTING

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CHALLENGES

CHALLENGES FACING WASTEWATER UTILITIES

- Declining customer demands
- Declining customer base
- Tightened capital market
- Aging infrastructure
- New regulations
- Current economic climate

PRIMARY CHALLENGE

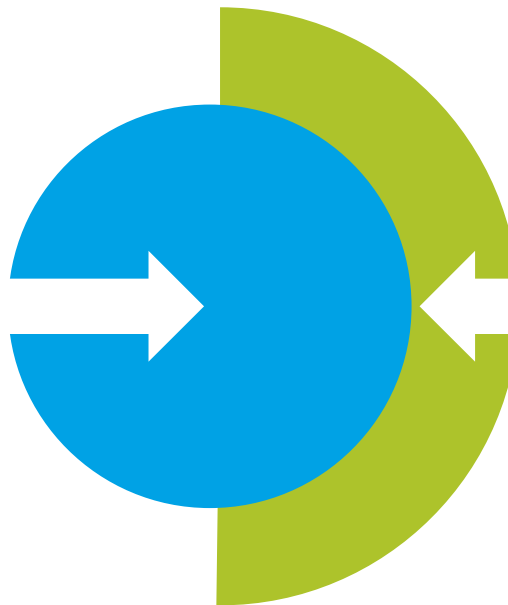
Revenue
Stability



Affordability

HOW TO FACE THIS CHALLENGE?...

INTERNAL
What wastewater
utilities are
currently doing...



EXTERNAL
What others are doing

EXTERNAL: LESSONS FROM THE GAS INDUSTRY

GAS INDUSTRY BUSINESS CHALLENGES

- Uncontrollable and unpredictable costs
- Continued declining use per customer
- Challenges to achieving customer growth
- Regulatory “lag” (process can be slow, costly, inefficient)
- Aging infrastructure and focus on system reliability
- Regulatory uncertainty

Much commonality with wastewater industry

EXAMPLES OF INNOVATIVE RATEMAKING USED BY THE GAS INDUSTRY

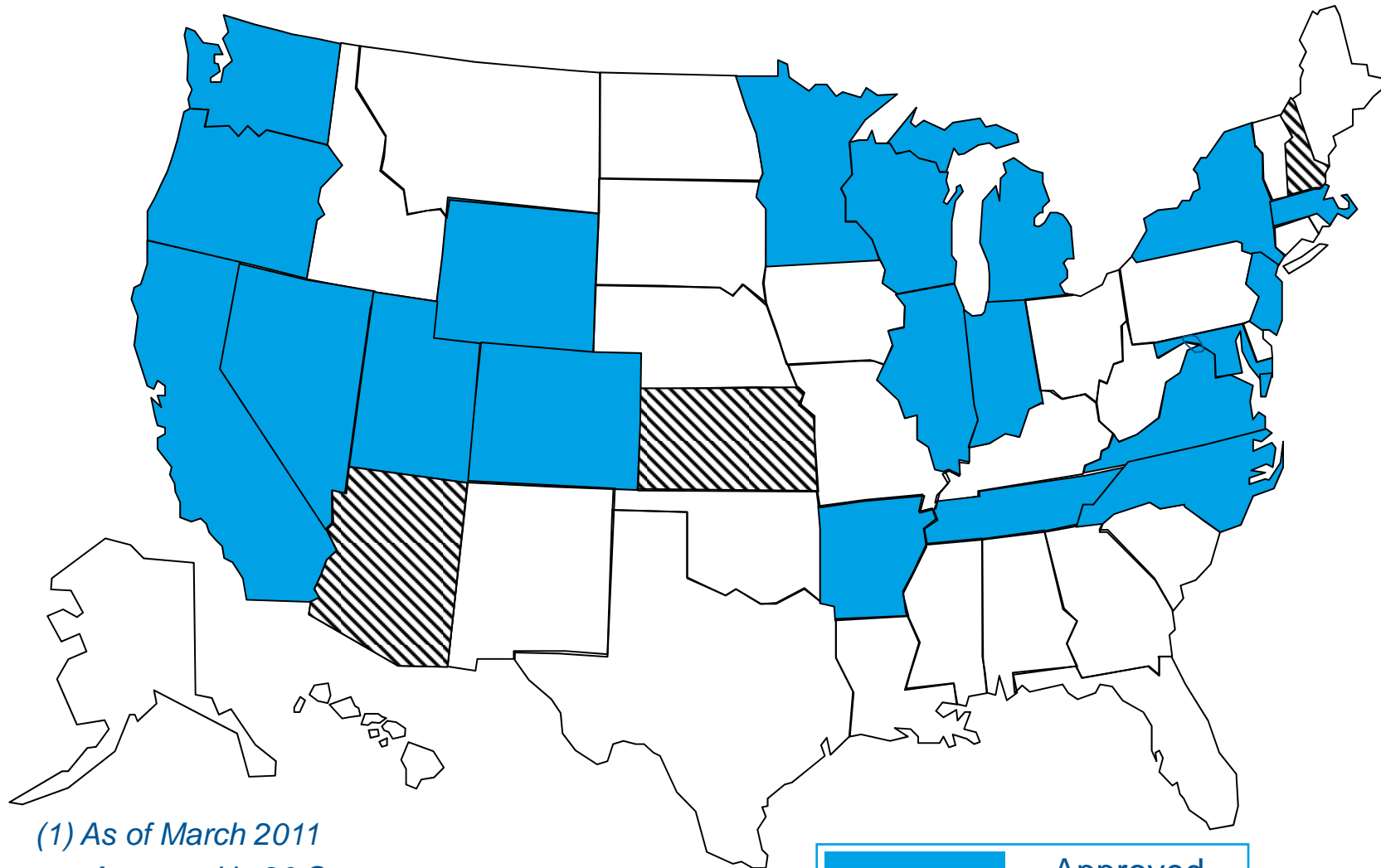
- Revenue decoupling mechanisms
- Rate design utilizing a straight fixed-variable (SFV) rate structure
- Automatic adjustment rate mechanisms or rate trackers to address:
 - Bad debt expenses
 - Infrastructure replacement cost
 - Energy efficiency program costs
 - Margin revenue losses due to warmer-than-normal weather

REVENUE DECOUPLING **BREAKING THE LINK BETWEEN A UTILITY'S** **REVENUES AND USAGE**

- Ratemaking and regulatory tool designed to break the link between a utility's revenues and the usage of its customers
- Removes the inherent economic disincentive that a utility has under traditional ratemaking to promote conservation
- The utility, knowing what revenue level to expect, is then free to take cost management actions to improve its effectiveness under this revenue level.

Improves ability of utility to recover fixed costs of providing service

REVENUE DECOUPLING – GAS UTILITIES ⁽¹⁾



(1) As of March 2011

Approved in 20 States

Pending in 3 Additional States



STRAIGHT FIXED-VARIABLE (“SFV”) RATE STRUCTURE

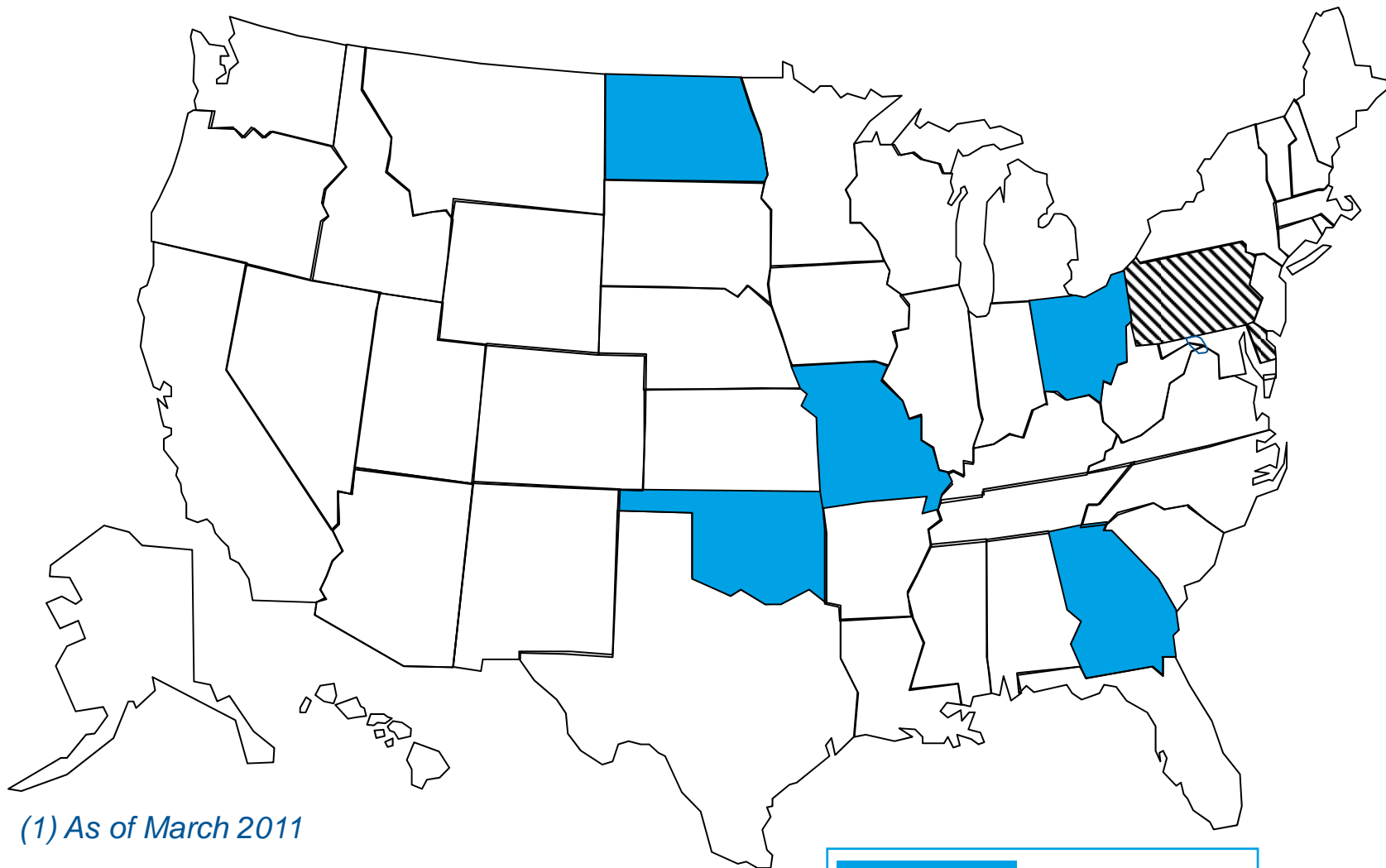
Can achieve some of the same outcomes as under revenue decoupling

- Effectively breaks the link between a utility’s revenues and the usage of customers by matching the rate structure to the cost structure
- Removes inherent disincentive that a utility has under traditional ratemaking to promote conservation

ATTRIBUTES OF SFV RATE DESIGN GAS INDUSTRY PERSPECTIVE

- Flat monthly fee places all of the utility's fixed costs, into a fixed monthly charge called a service or delivery charge
- Similar to monthly fee charged by cable, internet, cellular service, trash services, etc.
- The “variable” portion of the tariff refers to variable commodity-related charges (i.e., related to purchased gas costs)
- Improves bill stability for customer and is easy to understand
- Reflects reality that a significant portion of a gas utility's costs are fixed

SFV RATE DESIGN – GAS UTILITIES (1)



(1) As of March 2011

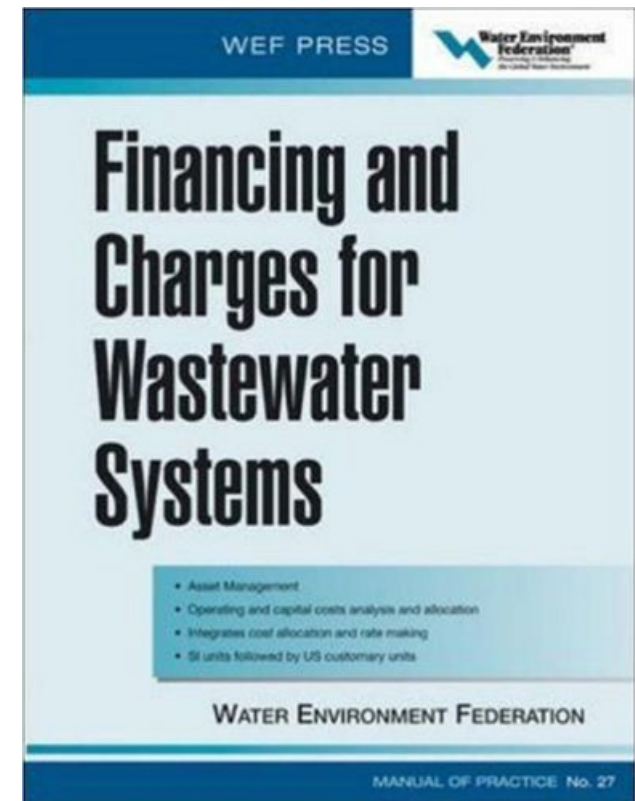
Approved in 5 States



TRADITIONAL COST ALLOCATION/RATE DESIGN APPROACHES AND POTENTIAL ALTERNATIVES

TRADITIONAL RATE SETTING METHODOLOGY(IES)

Water Environment Federation Manual of Practice No. 27 titled “Financing and Charges for Wastewater Systems”



PRIMARY COST ALLOCATION FACTORS

- Customer
- Volume
- Capacity
- Strength (BOD, TSS, TKN, P)
- Direct

Traditional Cost Allocation/Rate Setting Approach



EXAMPLES OF COMMON ALLOCATION APPROACHES / POSSIBLE ALTERNATIVES

COLLECTION SYSTEM

- Common: Volume or capacity
- Alternative: Small mains to “customer” component

INFILTRATION/INFLOW

- Common: customer / flow allocation (100% - 0% to 0% – 100%)
- Alternative: Reflect system characteristics
 - Increase allocation portion to customers
 - Incorporate into rate design

RATE DESIGN

- **Incorporate fixed costs into rate structure**
 - Service/customer charge (customer and meter costs)
 - Quantity allowance (all or portion of customer-related I/I)
 - Minimum volume allowance

WHY REVENUE STABILITY IS SO IMPORTANT...



BOND MARKET – WHAT ARE RATING AGENCIES LOOKING FOR?

Continued focus on financial condition

- Fund balances, debt service coverage, etc.
- Consistency/stability
- Political will for necessary rate increases

Increased focus on utility “strategy”

- Beyond financial condition
- Utility’s plan to mitigate issues that could impact rates and/or financial condition

CONSIDERATIONS FOR FINANCIAL PLANNING

Debt Service Coverage

- Policy/practice in excess of minimum requirements
- Stability over time

Reserve Funds

- Maintain required levels for required funds (e.g., debt service reserve fund)
- Adequate working capital
- Recognize rate structure / level of revenue stability
 - ...discussion will be that WC need not be 365 if 100% of charge is a fixed charge-30-60 days sufficient; higher level necessary

BENEFITS OF INCREASING FIXED MONTHLY CHARGE

- **Better recognition of fixed nature of most utility costs**
- **Could allow for more leniency with rating agencies regarding reserve fund levels**
 - Reduces political pressure to hold down or use the balance of any unrestricted reserve funds
- **Provides increased bill stability for non-residential customers**

DON'T FORGET!

Revenue
Stability



Affordability

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Together



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