

## 10 Factors To Consider When Updating Your Utility Rates

It is no secret that utility service providers are facing increased costs as well as aging infrastructure conditions that will soon need to be addressed. Combined with these challenges is a customer base that demands high-quality service at reasonable rates. Utility rate studies are the critical tool to address these challenges. The next time your agency considers a rate study, the following “Top 10” list will help you stay on the right track.

### **1. Develop a long-term financial plan**

Rate studies should incorporate all related revenue sources and expenditures, not just the utility service charges themselves. Include impact fee revenue, interest income and miscellaneous fee revenues. Your goal is to have a full pro forma that looks out 10 to 20 years for long-term planning.

### **2. Utilize strict cost of service principles**

Often, rate studies are dictated by policy decisions and stakeholder wants. These considerations work for the short term, but in the long run the consequences can prove disastrous. Making sure that rate analyses use supporting data and documentation and are utilizing principles endorsed by a reputable industry organization, such as AWWA and WEF, will enhance customer equity and understanding as well as defensibility. No one likes rate increases but you can you’re your customers understand the process which makes acceptance that much easier.

### **3. Establish formal fiscal policies**

If your rate structure does not include formal fiscal policies, consider adopting them the next time. Fiscal policies can range from defining appropriate reserve fund levels to setting a structured timeline for regular rate reviews. This measure alone often leads to fewer rate shocks in the future.

### **4. Review your General Fund reimbursements**

Few utilities set reasonable standards for General Fund or inter-fund allocations. Such transfers should be based on your agency’s indirect cost plan or similar documentation. If one isn’t available, allocate central service costs based on appropriate factors such as time spent supporting the utility, FTE or similar measure.

### **Know Your Rate Study Terms**

#### **Revenue Requirements**

Determination of utility revenue needs to meet utility during a certain planning period

#### **Functionalization**

A classification of cost data by functional category of a utility system

#### **Cost Classification**

The allocation of functional costs to utility cost components such as average water demand, fire protection, and billing services

#### **Base-extra Capacity**

An approach to measure costs associated with average utility demand (base) and peak demand (extra capacity)

#### **Uniform Rate**

Utility service billed by unit and at a constant price regardless of consumption amount

#### **Inclining Block**

Utility service billed by unit but the price per unit increases as consumption increases (also referred to as ‘tiered rates’)

#### **Water Budget**

An allotment of water to a customer based on customer’s efficient level of water use. This approach utilizes the inclining block method

## 5. Utilize tiered rates to encourage conservation

Conserving water resources is becoming a critically important policy goal for many communities in the United States. Utilizing an inclining block or tiered rate structure sends a price signal to users to conserve or risk paying higher utility bills. Consider them for your sewer rate structures, too!

## 6. Keep the customer in mind

These key principles amount to little if the end result significantly impacts your customer base. At each critical point in the rate study process, ask yourself how the resulting rates will impact your customer. If large rate increases are needed to maintain your utility's financial stability, make sure the customer clearly understands the reasons for the rate analysis and how you arrived at the final rate structure.

## 7. Avoid subsidizing customer classes

A true cost of service-based rate structure demonstrates the proportionate demand each customer class places on a utility. This approach ensures customers pay only their fair share of utility services. Subsidizing certain users with rate revenue from other users makes for good social policy but does not maximize equity and may invite challenges. If your agency's policy requires subsidization, consider other funding sources in lieu of rate revenue.

## 8. When comparing rates to other agencies, make sure it's "apples to apples"

It's nice to know how your rates compare to your neighbors' rates. A rate increase seems easier to implement knowing your rates are in the middle to lower range of the comparison spectrum. When you gather rate data from other agencies, ask a few simple questions such as: When was your rate structure last updated? What are the main cost drivers influencing your rates? Questions like these ensure your rate comparison has the best perspective.

## 9. Is your rate model user-friendly?

At the end of a rate analysis, the model used to develop the rates is an important tool for staff to use in the future. Variables that drove the rate study in the past may have changed. You want a model that is easy to update and will allow you to quickly generate a variety of "what if" analyses in the event of significant revenue or cost changes.

## 10. Ensure rate structure is compatible with your billing program

Finally, before you begin a rate study, determine the capability of your current utility billing software. If your agency charges a flat, bi-monthly fee for sewer services, can your billing program convert to a structure that features a combination of fixed and variable charges?

*TischlerBise conducts utility-related rate studies, financial plans and capital funding strategies across the United States. As a result of this focused experience, our consultant team is familiar with the issues and challenges facing utility providers and can apply this knowledge to provide a variety of cost-effective solutions.*

*Our utility financial team is a leader in assisting agencies navigate through these complexities to implement defensible utility financial plans and rate schedules, achieve long-term fiscal stability, develop sound fiscal policies, promote customer equity through strict cost of service principles, and ensure stakeholder understanding.*

### For More Information, Contact:

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