

Great Assets Require Great Rates

By Carl Brown

You can have great rates and great assets. Or you can have great rates and bad assets. But you can't have bad rates and great assets. At least, not over the long haul.

That is the crux of our asset management problem – our rates are just too low. To use the “which came first, the chicken or the egg” barnyard analogy, rates are the chicken, assets are the egg. I don't know which came first, but I do know where assets come from.

If you are to set great rates for your system, or if you are to help your client do so, there is a facet of human nature that you need to respect. That is, given the choice between forward-looking asset management at responsible current and long-term rates and short-term adequate management at a cheap current rate, ratepayers will usually choose cheap. Why? You can put it many ways but to put it bluntly, we all want what we can get or keep now more than what we can get or keep later, even if later is better for us. We are “me” and “now” centered. That's not a slam on human nature. All of nature has that outlook.

It actually takes books full of psychology to explain this and related principles, but you understand them intuitively. Does human nature preclude us from selling the notion of advanced asset management? No. But, we must prove to ratepayers that it is in their own self interest to fund well managed assets.

Most ratepayers are quiet and cool-headed and will follow a reasoned approach fairly willingly. Some – the CAVE people – want to organize the cool-heads against you and kill whatever you have in mind. (CAVE: Citizens Against Virtually Everything.) To prevent them from doing that you need to use a well planned and executed approach to rate setting. Here is a strategy to consider.

Rate setting needs to happen in two distinctly different parts. Part 1 is analysis. Part 2 is the political process of passing an ordinance and all that goes with it. The same people can do both parts, but if they do, some of the ratepayers will think the “fix is in.” Many will think and some will even ask, “Were the proposed rates cooked up to serve some under-handed purpose?” Your answer must be this:

“The rate analysis and rate setting processes were two distinct parts of the rate setting puzzle. They were done by completely different people. The rate analyst did the ‘math.’ We, your elected officials, did the rate setting based on the analysis results.”

Only the board or council can pass the rate ordinance. They should do so based upon information and advice provided by the rate analyst who is not a member of the board or council. The analyst might be an actual rate setting specialist, a consulting engineer, an accountant, a free service provider from an association or state agency or even the city or district clerk or finance director. Choose this person based on the system's needs and their ability to fulfill them, not just on availability. Rate analysis is complex and you want to get it right. It will be the underpinning for everything else you do.

Rate analysis is voodoo to ratepayers. It's almost as unknowable to many city and district decision-makers and staff, too. That's OK. There are specialists who know how to do rate analysis. Rate setting – the political process – is viewed by many ratepayers as dark, mysterious, even clandestine. Some boards and councils don't do a good job of dispelling that impression. But they need to if they want to be successful.

The best way to bring ratepayers around to accepting higher and restructured rates is to make the analysis as mathematically defensible yet as easy to understand as possible while making the rate setting process as transparent as possible. Ratepayers can't accept what they don't know. They can't know what is hidden from them.

There are many aspects to great rate setting. One key is this. Set your rate setting goals before trying to set your rates. Why bother with working out goals ahead of time? If you don't set goals first and have (almost) everyone buy into those goals, you WILL have people try to shoot down proposed rates later. They might succeed.

Consider adopting an ordinance or resolution that makes this goal statement: “The [council/board] of [your city] resolves to set and maintain utility rates and fees that are fairly structured for the ratepayers and high enough to adequately fund the system on a sustainable basis.”

By adopting such a goal statement you will have something to point to if someone tries to hijack the rate setting process or balk at paying rates that will adequately fund the utility. And, here's a helpful hint: You can't wait until you hit a rate increase logjam and then try to adopt the goal statement after-the-fact. Those who don't want their rates to go up will simply see this as an “end around” play. You must adopt your goal statement BEFORE setting out to analyze and adjust rates.”

We need to teach our ratepayers how to best satisfy their selfish interests concerning utility services. The first step is acceptable rates. The second is advanced asset management or something close to it.

Rate setting includes these four basic phases: goal setting, analysis, initial adjustment and future incremental adjustments. Simple to state and simple in concept, these steps cover critical and sometimes complex issues that need to be executed correctly.

It seems like many people want to dumb down rate setting by skipping many important issues. They just want to boot up a simple tool or spreadsheet, plug in a few numbers or answer a few basic questions and, BAM, they've got great rates. It just doesn't happen that way. While some of these tools can do the number crunching well, you need to plug in the right numbers and you need to understand the rate setting process and your ratepayers to actually get that rate increase passed. Your goal may not be headline-making, rate setting success. But, there is no alternative to learning some basics about rate setting even if you only want to keep your name out of expose' articles about rate setting shenanigans.

Time is your enemy. Time robs rate setters of their momentum to get the rate setting job done. Time robs rate increases of their ability to boost net revenue. Time is exactly why we have a funding gap in water and sewer that is measured in the hundreds of billions of dollars.

Rate setting is a thankless job. No board or council really wants to do it. Thus, they put it off. Even when they get started they discover troublesome issues, like the need to raise rates big time and how ratepayers feel about that. They have lots of reasons to not start on this task.

Other reasons pop up to halt the task midway. Even when boards and councils know what rate adjustments are needed they feel hesitant about "pulling the trigger" on a rate increase. Every time one of these time wasters pops up remember this mantra, "Just get on with it." Put your head down and charge ahead.

If you pass a rate increase ordinance after six months of deliberation you will feel justifiably relieved. You will be thinking, "Finally we have solved our income problem." Not completely. If you need rates that will generate an annual revenue increase of, for example, \$520,000, by waiting six months to get it done you will cost your system \$10,000 per week of deliberation and \$260,000 all together.

Before "deliberating" about rates you need to ask yourselves, "Will we improve the quality of our decision by more than \$x,xxx per week or are we just putting off a

distasteful task?" (Your analyst should tell you what your time cost is.) Usually boards and councils are not actually refining their decisions during that time lag. They are just not pulling the trigger on a decision that has already been made or that could be made quickly if they just got on with it.

Thus, time costs you money. You've heard that before.

Once you pass that big increase the next thing you think is, "I sure am glad that is done. I hope I don't have to do that again." If you pass an inflationary rate increase next year and each year that there is inflation in the cost to run the system, you probably WON'T have to do a big increase again. But if you don't keep your rates current with inflationary increases, after only five years of inflation at 5 percent you will need a rate increase of 27.6 percent due to compounding. At 10 years the increase becomes 62.9 percent. And these increases don't cover new needs like system upgrades and expansions. Do inflationary increases annually and you will probably never preside over a big increase again. Your ratepayers will like that.

In summary, there is much more that you need to know to get and keep great rates – rates that are adequate and fair. But always keep the basics in mind. You need to set goals, analyze rates, make the initial big

Rate Setting Phases

Phase 1 – Decide your rate and fee goals – your destination.

Phase 2 – Develop your own or "buy" a comprehensive rate analysis – a map – that leads to your goals. Usually this requires large initial rate adjustments and rate structure changes.


Phase 3 – Actually make those initial rate adjustments.

Phase 4 – Make incremental rate adjustments in future years – course corrections that are almost always small increases – to keep net revenues and other financial indicators on track with the projections from the comprehensive rate analysis for as long as possible.

increase and restructuring, and keep rates current every year. Educate and bring your ratepayers along and you will have great rates. Great assets will soon follow.

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EDITOR'S NOTE: This article is based upon the author's soon-to-be-published book, "How to Get Great Rates." To be notified by e-mail when the book is available, visit <http://carlbrownconsulting.com/> and sign up for the "Tool Shed."



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