BOARD FOR FINANCING WATER PROJECTS POLICY	EFFECTIVE DATE 03/04/98	PAGE Page 1 of 3
SUBJECT: REASONABLE WATER RATES		

STATEMENT OF POLICY:

The Policy on reasonable water rates was implemented in March of 1998.

PURPOSE:

To establish a policy / procedure for reasonable water rates for eligible public water systems.

BACKGROUND:

The Division of Water Planning, together with the Board for Financing Water Projects (State), evaluates water rates in communities receiving AB 198 Grant Program funds. The Division uses a simplified procedure to evaluate rates (described below) which should not be confused with accounting relationships or audit procedures and terms which are governed by Generally Accepted Accounting Practices, etc.

After evaluation of a utility's water rates and as a condition for receiving State grant funds, the Board may require a utility to make financial changes which will enhance the viability of the utility.

The State's objective in evaluating rates is to ensure that the water rates in place in a community are sufficient to ensure the financial strength of the utility. Through the rate analysis, the Division confirms that grant recipients will have sufficient revenues to: 1) operate and maintain their systems; 2) retire the debt which may have been incurred in constructing their systems; and 3) to replace portions of the system which become functionally obsolete or worn out. Further, the rate analysis is performed to ensure that potential grant recipients are "helping themselves" by charging a "reasonable rate" for water. Some systems become candidates for State grant funds because long term revenue deficiencies have precluded the upkeep of their systems. Other systems become grant candidates due to their inability to cope financially with new requirements in health regulations.

Ultimately the State's goal is to ensure that grant receiving communities will have funds to continuously renew and upgrade their systems. When this is accomplished, it is expected that the utility will have achieved financial self-sufficiency.

AB 198 GRANT PROGRAM REQUIREMENTS

The Board for Financing Water Projects endeavors to provide grants where State funds can restore the financial self-sufficiency of a water utility. This objective is deemed met if the project can be demonstrated to be "economically justified and financially feasible."

"Economic justification" requires that the project obtain benefits proportional to its costs, and that the selected project alternative is the most economical or the solutions considered. This evaluation generally requires that applicant to consider the present worth of the cost of operations and maintenance in addition to initial capital costs. This concept also requires consideration of a "no project" alternative.

When customers regard the water commodity to be worth its cost and are willing to (and have the purchasing power to) pay that cost for an average amount of water, a proposed project is considered to be "financially feasible." Projects which are financially feasible will have revenues which meet or exceed expenses.

BOARD POLICY:

REASONABLE RATES

A determination as to whether the grant applicant is charging "reasonable rates" must be made before the Board can award a grant. As the money granted to projects comes from property taxes paid throughout the State, the Board has an obligation to see that grant recipients are contributing a reasonable amount toward water rates before the State awards any grant funds.

A 1991 survey of over 90 water systems around the State showed that many systems charge between $30 and $40 per month for a volume of 22,000 gallons. Of course, some systems charge less, and some others charge considerable more. It is the Board's policy, therefore, that unless there are exceptional circumstances, customers in a community receiving a grant must pay no less than $30 per month for water before the State contributes grant funds. In communities which are financially stronger, the Board may determine that higher rates are reasonable. Another way to calculate a reasonable rate is to base it on 1 ½ % of median household income for a community (e.g., 1 ½ % x $24,000 = $360 per year or $30 per month). In communities with lower median household incomes, a reasonable rate may be lower (e.g., 1 ½ % x $20,000 = $300 per year or $25 per month). The Board may also consider other factors impacting the financial strength of the community when making its determination (property tax rates, etc.) as to a "reasonable rate."

RATE COMPONENTS

As noted earlier, water rates are expected to provide revenue for three purposes. The first, and most essential use is for operations and maintenance. Falling in this category are the day-to-day expenses of sustaining the system. Costs placed in this category include salaries and benefits, chemicals, electrical and telephone utilities, repair materials and supplies, small tools, equipment, fuel, etc. Salaries can be further described as including the costs of field and shop labor, but also the cost of administrative efforts such as meter reading and water invoice preparation. A good system of accounts in a utility will help its managers and directors to understand how much each of various activities contributes to the total cost of running the system.

Secondly, water rate revenues are used to retire debt. Debt retirement means making the payments on loans obtained by the utility. Loans may have been received from credit unions or banks, or through the sale of general obligation or revenue bonds. Loans impact both the balance sheet and income statement of a utility. The amount of the loan payment due in the current year must be obtained from current water rates, or some other source such as property taxes which can be collected by the utility.

Thirdly, water rate revenues are used to fund depreciation. Depreciation is simply a value assigned to the loss in value of a utility's assets. It recognizes that over time, each of the components of a system wears out or becomes functionally obsolete (undersized for example). All systems must have regular investments in new facilities or they will fall behind current standards for performance, reliability, and safety. The Division and the Board regard continual reinvestment in a system to be crucial to its ongoing viability.