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UNDERSTANDING AND COMMUNICATING CALIFORNIA'S RISING WATER RATES

There is no end in sight when it comes to the pressure to raise water rates in drought-fatigued California. The chronic drought, combined with continuing water conservation mandates, landscape changes and other circumstances have created an environment of uncertainty for water sales. Communicating necessary rate increases to customers who have met or exceeded conservation targets poses another challenge. The good news is that southern California, especially Los Angeles County, historically has among the lowest water rates, according to studies. The bad news is that, with or without drought, pressure to raise rates will continue due to continuing fixed costs such as repairing aging pipes, employee salaries, renewable energy goals and compliance with ever more stringent water quality regulations. Moreover, there are strong indications that the water use restrictions ordered by the State Water Resources Control Board in response to the drought may become permanent.

If you're in the water business, the question that has come up more frequently in recent months is, "why are my water rates rising if I'm conserving water?"

The short answer: It's complicated.

"Water has many issues facing it," said Sanjay Gaur, Vice President of Raftelis, a Los Angeles financial consulting firm that serves water utilities nationwide. "You don't pay for water. You pay for the ability to use water."

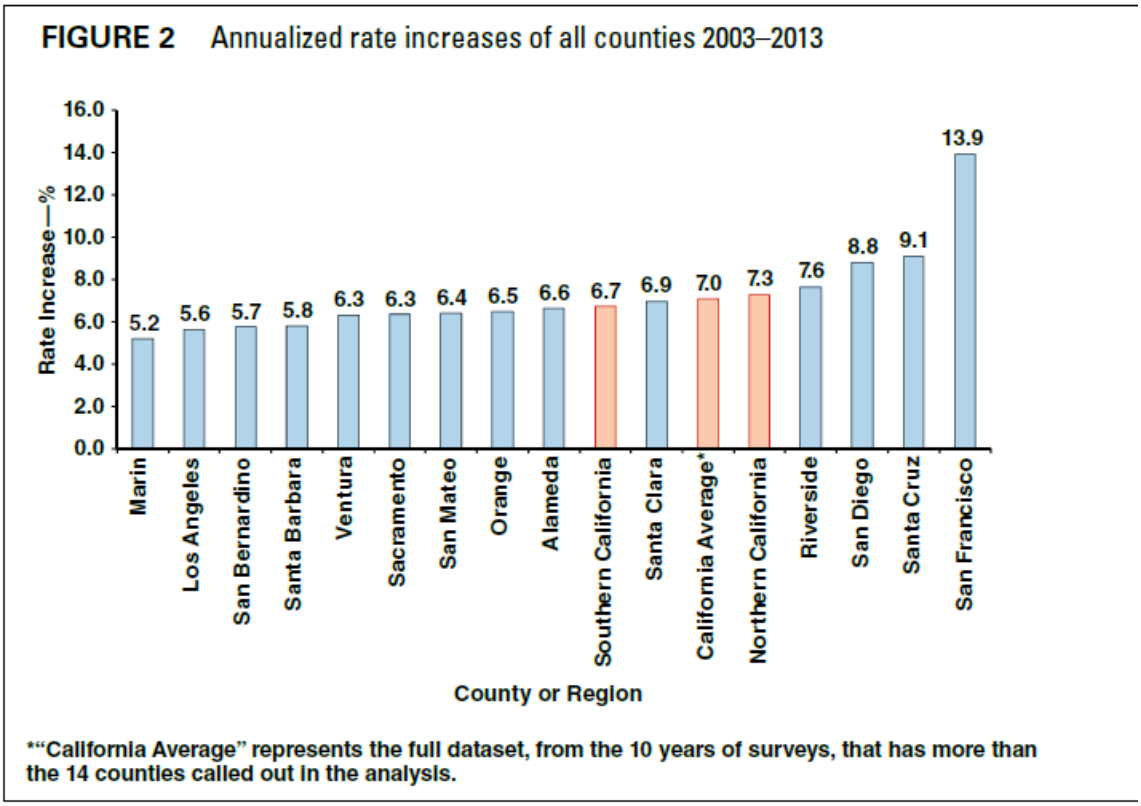
The San Gabriel Valley encompasses a diverse topography in which residents in a mostly urbanized region can escape the crush of traffic for the backyard beauty of the San Gabriel Mountains. This landscape, though, when coupled with the diversity of water utilities, state water conservation mandates, water quality regulations, the ongoing drought, and a disappointing El Niño rainfall, creates an environment of uncertainty that can ultimately impact water rates.

Understanding uncertainty, as well as evaluating regional trends in water pricing, is critical to addressing and communicating water rate structures effectively to water customers.

"Water rates have not been predictable or steady for many years," said Brian Thomas, Managing Director of the Los Angeles-based firm Public Financial Management. "Many agencies have gone a decade without raising rates – then find themselves in a position where they have to increase rates dramatically in order to finance needed repairs or new water supplies."

California water rates have been steadily rising, according to a 2015 analysis published in the Journal American Water Works Association by Gaur and Drew Atwater, a senior financial analyst at Moulton Niguel Water District. The study, "California Water Rate Trends," analyzed water bills from 2003 to 2013 in 14 counties in California—seven from Northern California and seven from Southern California.

In Los Angeles County, the average monthly bill rose from $31.63 to $54.59, during the ten-year study period. This may come as a surprise to some but, in comparison, Los Angeles County had the second lowest annualized percentage increase, averaging 5.6% in the state, compared to San Francisco, which had the highest rate increase at 13.9% during the 10-year period.



Source: "California Water Rate Trends," by Sanjay Gaur and Drew Atwater, Journal American Water Works Association, January 2015.

Many water sellers experienced reduced financial margins and had to increase water rates to protect revenues, following Governor Jerry Brown's declaration of a statewide drought in January 2014 and subsequent mandatory water restrictions. Water suppliers understand that even with intensive conservation efforts, water rates for most residents will continue to climb.

"The drought has been the single biggest factor driving higher water rates in California over the past few years," said Andrew Ward, Director of U.S. Finance for Fitch Ratings. "Water utility revenues are driven by the amount of water Californians use in their homes and yards. When people conserve, they do their part to ensure adequate water supplies for the future, but they also eat into the water provider's bottom line. Water agencies have many fixed costs. When they sell less water, most have to raise the price of each remaining gallon sold to be sure they can continue to make debt payments, maintain their infrastructure and make new investments in safe, reliable supplies."

Kevin Wattier, a water consultant and formal General Manager of the Long Beach Water Department, said that attributing rate increases solely to water conservation, a common theme in news media, oversimplifies the issue.

"Water conservation justifies rate increases…that's a myth. It's just not true," Wattier said. "In the San Gabriel Valley, most agencies rely on local water groundwater supplies than imported water, which costs more. So whether (residents) conserve water or not doesn't really matter when it comes to water rates. The routine costs of employee salaries, water quality treatment, fixing pipes and replacing pipes still have to be passed."

Increasing water bills has also been attributed to salary increases for employees of the Department of Water Resources, which are factored into fixed costs, in addition to infrastructure renewal, maintenance, and insurance. Furthermore, in October 2015, Governor Brown outlined an ambitious plan for retail sellers and publicly owned utilities to increase the percentage of renewable energy in the state's generation of electricity to 50 percent by 2030. This green power, which comes in the form of solar and wind power sources, is also a major component for water suppliers.

Water costs trickling down from the state, to the Metropolitan Water District, to the local water sellers ultimately influence a customer's water bill.

"Green power is more expensive than what we are currently using, and it gets passed on to all customers. By the time all these costs get to a water utility, the end user feels the impact," said Craig Gott, president of the Southern California Water Utilities Association.

Variable costs, including the acquiring, pumping and treating of water, as well as socioeconomic factors, change with the amount of water customers use, even if we conserve water. One way to explain this to customers is to compare it to the costs of owning a car.

"If you own a car, you likely have monthly loan payments and insurance," Gott said. "The more you drive the car, the more you have to pay to use it…costs such as gasoline and maintenance. But even if you don't drive the car, you still have to pay your monthly lease and insurance. You pay for the utility of driving a car to go places, similar to how you pay for the utility of water in your home even if you don't use a lot of water."

The cultural landscape of water use is changing as policy makers and the public realize more and more that water is becoming a scarcer and more valuable resource. Some experts recommend turf replacement and drought tolerant landscapes as part of the solution, while others focus on replacing old infrastructure. All factors considered, water experts agree that suppliers need to emphasize water conservation.

"We have to use less water because less water is available at the end of the day," Gott said. "The drought is real. It's not going away."