

# Vernonia Needs to Change its Water Rates

By Jim Tierney and Dale Webb

The Vernonia Public Works Committee has been considering how to keep our water and sewer rates as low as possible over the long haul. Like most things in life, saving money in the long run involves giving something up in the short run. So it is likely to be with our water and sewer rates in the near future. This is the first in a series of articles that your Public Works Committee proposes to publish to help the citizens understand the complexities that we and the City Council see as affecting your future water and sewer rates.

This article is intended to give you some understanding of the city's complicated public works budget, and explain the need to set aside reserves to replace our aging water and sewer systems. In our next article, we'll explain the several ways different cities approach setting rates, together with an objective discussion of the underlying philosophies behind those rate setting strategies.

Responsible leaders in charge of any expensive facility typically set aside a reserve from the rates to replace the facility and its parts as they age and wear out. For most homeowners this might include setting aside \$500 a year to replace the roof, or a similar amount to help pay for painting the house every 7 to 10 years. When your facilities are worth millions of dollars, this kind of prudence becomes even more important.

Historically, Vernonia's leaders have tried to keep water and sewer rates as low as possible. By focusing on only the "hard" operating costs to craft rates for users, our leaders erred, neglecting the City's responsibility to set aside reserves for replacement. Because we have in the past been able to raise significant capital through state and federal grants, we have been able to keep our system functioning despite having effectively set aside no meaningful reserves for replacement from within our rate structure.

Unfortunately we cannot continue to depend on this approach. For the last 20 years state and federal grants for water and sewer projects have been diminishing and are now virtually nonexistent. The best we can hope for is reduced interest rates rather than large outright grants. Recognizing this changing funding environment the Public Works Committee and City Council have concluded that it is in the best interest of our rate payers to begin setting aside sufficient reserves for future replacements of our water plant

and distribution system. By raising the monies needed for these projects over a long period of time, we can best stabilize our future rates.

conversations should be establishing cost reduction goals for the city administration.

It is important to be aware that we have two types of reserves. The fact

### Below Is a Simplified Version of Our Current (2011-2012) Budget

Personnel, Treatment Expense, Material & Operating Costs	\$ 382,370
Contingency (Annual Reserve for Unpredicted Repair Costs)	31,720
Loan Reserves* (One time pmt. to replace required Loan Reserves)	95,960
Capital Reserve Payment	60,000
Annual Debt Service	119,949
<b>Total Budget</b>	<b>\$ 689,999</b>

\*Since this loan reserve payment is a one-time transfer of last year's cash to the required loan reserve budget, the real annual, steady state Water System Budget is \$594,999, or there about. That is assuming that we continue, as we should, to sequester \$60,000 each year into our Capital Reserve budget, from the system's operating budget.

Personnel and material costs include: electricity, chemicals, hardware, public works personnel, office billing and accounting staff and some charges for city administration. This budget also includes a line item for Contingency. In this case, the Contingency amount is our best guess of the actual unexpected water system costs we will have to do in any given year. Contingency funds left unspent, get rolled into the next year's Public Works Budget.

Capital Reserves is what most budget analysts would call a Reserve for Replacement. It is this category that we believe must be strengthened and protected, just as you might protect your retirement account. Annual Debt Service is non-negotiable to the city just as your mortgage or rent payments are nonnegotiable to you.

At this point during a typical Vernonia conversation about water rates the conversation changes into a grumble that we should save money in the operational budget before setting aside reserves. Saving money and holding our public servants accountable are both excellent ideas. However implementing these good ideas is an ongoing management task, completely independent of the need for reserves. We should be looking for operational savings whether or not we have adequate reserves in the budget. One way to accomplish both goals is to have a public rate conversation periodically, probably every two years. Part of those

that they use the same name can make our communication very confusing. To understand them, it is best to focus on their purposes. The first type, a Loan Reserve is typically required by lenders when the city borrows money. These reserves are our way to assure our lender that they will not lose money on our loan. As a result, our lenders give us lower interest rates and loan over a longer period of time, lowering our payment. Our water and sewer rates are seen by the lender as a dependable source of income, and this too encourages the lender to give the city more attractive loan terms. Nevertheless, lenders always require us to maintain significant cash reserves to protect them. These loan reserves are typically funded only once when the loan is originated and they cannot be touched without violating our loan agreements.

The water rate surcharge the city added several years ago is an example of what happens when cities do inappropriately spend those funds. In our case, according to some rumors (no one here seems to really know), the city spent some of the reserve funds related to one of our loans, and we got caught. Our lenders then required us to replenish that loan fund very quickly, so we had a large, unexpected increase in our water rates. Other than this "catch up" period, which is final with this year's budget, we do not make annual or monthly payments to loan reserves. They just sit in the bank protecting our lenders.

The other kind of reserves, Capital Reserves, represents financial discipline we apply to ourselves. It's not very different than setting aside money every month to pay for your child's college or your annual tax bill. The "reasonable" way to accomplish this is to "disassemble" our entire water system into its discrete component parts and then make guesstimates as to the remaining

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reflecting the spirit of our community

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(24 issues) \$35

Vernonia's Voice is published  
on the 2nd and 4th Tuesday  
of each month.

**Vernonia's Voice, LLC**  
**PO Box 55**  
**Vernonia, OR 97064**  
**503-367-0098**

[www.VernoniasVoice.com](http://www.VernoniasVoice.com)

life of each of the components. To this we add an estimate of the cost to replace each component. Using this data, we have the basis for the large, long-term, savings accounts we must create if we hope to be able to replace our very expensive water system components when they wear out.

Our intent in writing this article is to help you, the rate payer, understand what all the reserves, and contingencies do. And, we are hoping that many of you will absolutely insist that we maintain these prudent budgeting systems into the future. This thoughtful prudence is always the first thing to get lost as the public reacts to rate increases. Because we believe that some future rate increases are inevitable, we will continue our effort to build knowledge and understanding through these periodic communications with you, the public.

The next article, which we will publish in the near future will discuss the various proposals to reform how we structure the charges for water service so that we can be sure we have the money to operate the budget above.

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