Vernonia's Impending Water Rate Decision: A Personal Perspective

By Jim Tierney

As described in a previous article, Vernonia has not systematically set aside funding to repair and replace its very valuable water and sewer infrastructure. In addition, our water system has been relying on funds carried over from previous years to meet operating costs; all without a rate increase. Both the Public Works Committee and the City Council have acknowledged that a significant rate increase must be imposed to keep the system solvent. Both groups also believe that the rate increase should include reconsideration of how our current charges are calculated.

Within both the Public Works Committee and the City Council there is disagreement about how our water rates should be structured. The disagreement falls along opposite views of how we should pay for public utility services. In order to understand the disagreement, consider two other common household expenditures as models for the two perspectives involved. The first model would be gasoline. You pay the same price per gallon at the pump as everyone else. Now, imagine a health club membership. With health clubs you pay a monthly or annual fee and use that club as often or as little as you care to with no change in cost. In a nutshell, essential utility systems (water, electric and sewer) attempt to navigate a middle ground between these two extremes.

The capital-intensive nature of public utilities has two significant real world impacts which policy makers must consider. First, it leaves utility systems that build too much of their costs into the per-unit rate making them vulnerable to a downward spiral of conservation (reducing the units used.) Secondly, communities are made up of a wide variety of households with different economic and personal circumstance. Differing use patterns and sensitivity to cost inform each owner's price sensitivity. This creates a zero-sum rate setting game between household types; that is a better deal for one household type is likely to be worse for another.

Like many things in life, a middle ground for utility rates makes the most sense. In this case, there are two good reasons, one ethical and the other practical. First, public utilities are virtually impossible to live without. This fact makes the health club model an unreasonable burden for low income households, large families and seniors struggling to maintain a budget. The other reason to adopt the middle ground is that utility systems are an enterprise and can lose money. It is possible to structure rates to encourage too much conservation (reduction in use), making the pure price per unit (gasoline model) too risky for the city. If too much conservation is triggered it hurts the utility systems bottom line.

The City of Vernonia hired the Oregon Association of Water Utilities (OAWU) to help us develop our rate system. These experts informed us that the water rate "sweet spot" is collecting 60 to 75% of system income as a base rate. In their experience, base rates in this range do not trigger excessive conservation.

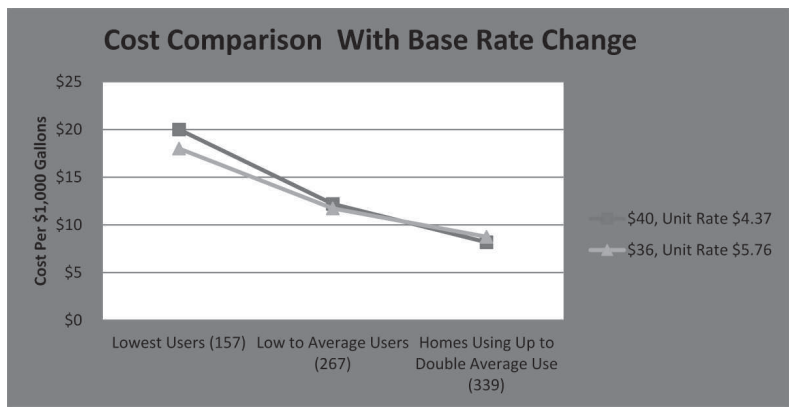
The "health club" model I will label here as the "Fixed Cost" view. This idea suggests that every user who connects to the system should pay an equal amount for the privilege of having the first drop of water or the first kilowatt of electricity provided to their home or business. The essential assumption here is that all users benefit equally from being connected and should therefore pay the same for that privilege. In this view, after the base rate, a user should pay the actual "wholesale" cost to produce or provide that service, excluding that base rate which covers the shared "fixed costs". This is essentially the model we use for our current water rates.

In the "gasoline" model all users pay strictly on a "Consumption Basis." For example, any homeowner using 4,000 gallons of water each month should pay twice as much as a homeowner using 2,000 gallons. You can substitute kilowatts of electricity or wastewater flowing into the sewer. The concept is the same.

As noted above, there is a corresponding, but different practical problem with the strict adherence to a consumption rate. This is the potential for a rate "death spiral." At a time of rate increases, consumers might unexpectedly make dramatic reductions in their consumption, as a way of keeping their personal costs constant. This leaves even fewer consumers to share the increased cost burden that triggered the rate increase in the first place, requiring further rate increases. As you can imagine, this can lead to an economic death spiral for the utility.

In most cases, cities balance these tensions by selecting base rates in the 60 to 75% range mentioned above. This is considered safe because it protects the community system from the death spiral effect discussed earlier. For many communities this safe harbor does not provide sufficient incentives for conservation and means that the rates have a "regressive" quality that is seen as hurting households occupied by elderly and low income families. Sometimes these communities set rates using a "tiered" system which increases the cost per gallon as households use larger and larger quantities of water. These tiered systems are often modified to account for extra water usage for lawns and gardens. Sometimes this modification reduces the charges for such summertime usage. Other times communities actually increase charges for the summertime in order to create a disincentive. This is often done in drier climates where water shortages are chronic. The City Council has already rejected the idea of a tiered rate, a decision that I support.

Within the Public Works Committee the two poles would make two different arguments (among others.) First, one side would say that users who use less than 2,000 gallons a month are getting "hosed," to paraphrase one of the Committee's members. I fall into this camp. The other perspective is concerned that the increased revenues needed to balance our budget will be disproportionately shouldered by the larger users of the system. I fall into this camp as well – both in what I believe and in what I will have to pay. I have included two charts with this article that prove both of these points. The line graph shows that the average household using less than 2,000 gallons pays more than twice as much per gallon as the highest use households. At the same time, as shown by the bar graph, even the highest suggested base rate ($40), the 20% of users who



continued on page 19