



WHAT TYPE OF RATE STUDY DO YOU NEED?

It's time for a rate study...

You've managed your utility well, kept costs down, and have a safe and reliable system. However, inflation, a capital project, or the need to hire additional personnel require you to raise rates. Easy enough - you know there are rate consultants out there that can help you determine how much of an increase is needed. *But, did you know that there are two primary types of "rate studies?"* The costs and the level of analysis associated with each is very different and you should know the differences in order to determine what you need.

The first option is a **Full Cost of Service Study**, which assigns costs to each customer class based on each classes' contribution to the expense of running the utility. These costs may be allocated based on the number of customers in a class, usage and demand data, and class-specific investments. The results of this kind of study provide a very detailed insight into the cost of delivering service to each class and identifies any inter-class subsidies that may exist. This allows recommendations to be made for individual classes, and changes to be made in rate design so that cost recovery more closely mirrors causation.

The second option, sometimes called a **Financial Rate Plan**, consists of a review of when increases are needed and how large they need to be to meet the overall revenue requirement of the utility. Unlike a **Full Cost of Service Study**, rates are not adjusted on an individual class basis. Instead, often the consultant will recommend a blanket increase - for instance 5% - which is applied to all existing rates regardless of class.

A **Full Cost of Service Study** requires much more work and time - both on the part of the utility staff and the consultant - as a significantly larger amount of data must be provided and analyzed, and additional discussions regarding rate structure and cost allocation are required. A **Full Cost of Service Study** is more expensive to perform. However, there are several benefits that a **Full Cost of Service Study** provides that a **Financial Rate Plan** does not:

- **Fairness** - Costs are assigned according to what is causing them, ensuring that each customer class rates are set to recover the appropriate revenues. Sometimes an immediate move to full cost may not be recommended due to customer impacts, but the study provides guidance moving each class towards actual cost.
- **Industry Acceptance** - The American Water Works Association (AWWA) recommends the Full Cost of Service Study approach.



Know the differences to determine what you need...

- **Defendable** - If rates are challenged by customers, there will be a very reasonable basis for the rates as they were assigned using cost causation.
- **Detail** - A Full Cost of Service Study allows costs to be presented by their functional unit (e.g. billing cost per bill, treatment costs per gallon of water) which helps determine the portions of the total cost that should be recovered through customer or volumetric charges.

Typically, we recommend that a utility with multiple customer classes perform a **Full Cost of Service Study** every five to seven years. In the interim, if needed, we recommend **Financial Rate Plans** based on an update of the existing Full Cost of Service model, with changes for growth, debt service and budgeted expenses. Regardless of which study is most appropriate for your utility, there are several deliverables you should expect to get with any rate study:

- A **report or presentation** showing what kind of analysis the consultant did, the results of that analysis, and the recommended rates or increases.
- A **customized, non-licensed copy of the model** that was used to determine rates, under the utilities' control, that can be used by utility staff. Some rate consultants may restrict access to, license, or require a subscription for access to modeling software, however, the utility has paid for the model and should have ownership. ■



If you have any questions or want to learn more about rate studies for your utility, please contact:

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