TACIR Commission Meeting

10/23/2013

MTAS COMMENTS ON HOUSE BILL 600

1. This bill limits the water outside rate to 150% of the inside water rate for Johnson City, TN. It appears that the current outside water rate is 200% of the inside water rate.

2. There is no discussion in the fiscal impact as to why 150% is recommended in HB 600.

3. There is no discussion in the bill summary as to what cost based defense was supplied to support the current outside water rate structure for Johnson City, TN.

4. If HB 600 passes, Johnson City inside city water customers would have to create an additional $450,800 annually in order for the water fund to break even.

5. MTAS believes that cities are legally different from utility districts. A UD has customers in its service area only. A city has defined corporate boundaries although it may serve water customers outside its corporate boundaries. A city owned water system's primary customers are its residents (owners).

6. MTAS believes that cities have a mandate to create and charge a higher rate for utility services outside the city customer area when there are additional costs of providing service to non-city customers. In other words, city customers should not subsidize non-city customers.

7. MTAS believes that each city's rate structure and cost of service delivery be considered separately without any limit on the inside/outside rate differential. MTAS believes that a 150% limit on outside rate differentials Statewide may be unfair to some cities. The cost of constructing a water system varies across the State and greatly depends on the geography, condition of the soil, and treatment requirements of the raw water. Hilly terrain requires strategically placed water storage tanks. Rocky soil increases the costs for line installations. Some well water is cheaper to treat than surface water. Simply put, a

statewide limit of 150% of the inside rate to provide outside city utility service across Tennessee may be unfair.

8. MTAS believes that each city should be able to document any rate structure differential with the cost and description of reasons for an inside/outside rate differential. This would be a cost based approach.

9. To the extent that the State limits an inside/outside rate differential, cities may have to increase the amount of their tap fee to non-city customers to compensate for the lack of revenue from water usage. City customers should not subsidize non-city customers.

GENERAL REASONS FOR AN INSIDE/OUTSIDE RATE DIFFERENTIAL

1. In principal, the inside city customers are owners while all outside city customers are non-owners. Owners of the system are entitled to a fair rate of return on their infrastructure investment and their assumption of risk. The owners must deal with water permitting, the EPA, and potential fines.

2. There are inherent costs and potential liabilities facing owners but never facing non-owners. For example, water system debt can adversely affect the interest rate on future general fund debt. These costs of ownership are real but are often not quantified.

3. The owners of the water system are responsible for operations which must abide by state and federal environmental regulations. This is a potential liability borne only by owners as a non-owner may choose to purchase their water elsewhere.

4. System development charges or capital recovery charges are not normally recouped through tap fees in Tennessee. Therefore these costs are recouped mainly

through future utility rate fees. Essentially, the city is selling its water fund's extra capacity. The extra capacity comes at the cost of building the water infrastructure larger than required for city only water service. Tap fees are generally low, often recouping the water hook-up cost only. Higher outside utility rates are the main way Tennessee cities recoup the cost of infrastructure.

5. Certain infrastructure may be built for outside customers only such as water storage tanks located outside the city. There is the obvious infrastructure outside the city limits but infrastructure inside the city may need to be sized larger to accommodate the increased flows. The extra construction costs would be reflected in higher depreciation expense and debt service. This means that the cost of providing water per customer outside the city will be greater than that for an inside customer.

6. Population density is usually less in the county meaning that there are fewer water customers per mile outside the city. Meter reading, line monitoring, maintaining adequate water pressure, and maintenance cost more per customer outside the city due to this extra distance.

This is another reason that the cost of providing water per customer outside the city will be greater than that for an inside customer.

HOW WATER RATES ARE SET BY MUNICIPALITIES

1. Most initial water rates are determined by the city working with its engineer.

2. Subsequent rate increases generally do not alter the rate structures or inside/outside rate differentials. If the city needs an additional 20% increase in revenue, then all rates generally increase by 20%. This is called the cash needs approach.

3. Sometimes, there may be percentage changes to the minimum bill that are different from the cost of treatment changes. The resulting total revenue would still produce 20% of new revenue. Elected officials are sensitive to the amount of the water minimum bill.

4. Expansion of the water system usually leads to a rate study and rate increases. If the water expansion is solely for outside water customers, the entire cost of the expansion should be allocated to the outside water customers resulting in a higher outside water rate.

5. Occasionally, MTAS will perform a cost of service rate study which provides information relative to the cost to serve and the revenue produced by customer class and inside versus outside customers. In addition to recommending an adequate rate increase, information would be developed concerning customer equity. The costs of service would be developed along with the revenue produced by customer classes within the city and outside. Ideally, the costs of service would be offset with the revenue produced by customer class.

6. To the extent that the State limits an inside/outside water rate differential, cities may have to increase the amount of a water tap fee to non-city customers to compensate for the lack of revenue from usage. City customers should not subsidize non-city customers.