

# The Gold Standard Approach to Securing a Stronger Financial Future for Your Water Utility

By Ann Hajnosz, PE

## Executive Summary

Water utilities are trusted stewards of long-lived critical infrastructure assets. But many agencies are struggling with a daunting challenge: how to plan and pay for the tremendous backlog of replacing this aging infrastructure.

While each utility's circumstances are unique, there is a Gold Standard approach to planning that will better align a utility's financial future with the assets they must protect.

Customizable to any community, the steps in this approach help agencies efficiently address their infrastructure funding challenges by gaining buy-in from all stakeholders—including both internal and external decision makers to customers—while providing increased clarity of utility priorities for staff and avoiding common pitfalls.

## Water's New Normal

Water utility funding used to be simple. Through the 1980s, rates were low and reliance on federal subsidies was common. Times have changed.

Federal subsidies have dried up, plants and pipes are deteriorating fast, and state and local governments, i.e. ratepayers, are now the principal source of funding for utility operations. These customers are feeling the pressure from not only water utilities but other demands on their wallets as well. As a result, customers demand more transparency regarding costs and inclusion in decisions that affect their budgets.

Across the country, agencies of all sizes have found ways to proactively address this new reality. They have adopted a Gold Standard approach to planning that helps them achieve their goals. Your agency can do the same.

Following all of the steps in this approach is optimal, but incorporating even some of them should help you gain clarity, financial security and the necessary buy-in around how to pay for future infrastructure projects.

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# The Gold Standard, Step by Step

The Gold Standard takes a holistic planning approach, and for a good reason: Bringing every element and all stakeholders into alignment is a recipe for success. Each ingredient adds to its effectiveness.

## STEP 1 SETTING YOUR BIG-PICTURE STRATEGY (STRATEGIC PLANNING)

### Align your team

To understand what you are dealing with, you have to break down the silos and get everyone talking. In an ideal strategic planning effort, leaders and staff throughout the agency come together to discuss their goals and how those goals support the overall mission and vision of the utility. Whether it be maintaining a high level of efficiency to meet current utility demands and maintain a high level of reliability and safety, or preparing your staff to be flexible in meeting new and emerging issues, or both, strategic planning is an approach to align all utility resources towards a common goal.

A big part of these types of efforts involves understanding your team's communication and leadership styles. Being open to learn new perspectives and think differently are keys to coming together as a team and embracing your utility's vision and mission. Often multiple workshops and all-hands meetings are utilized to prioritize strategic objectives and identify potential organizational enhancements, performance metrics, and process improvements, to seek input and feedback from staff and to gain endorsement of strategic issues, goals, and actions. Board members and other outside decision makers can also be part of this process.

If it has been awhile since your utility has engaged in long-term planning, prepare to open Pandora's Box here: Not everyone will agree or start from the same assumptions. Yet as they talk, they should start to see plenty of common ground and find ways to align priorities across departments. Ultimately, this forms a framework for moving ahead and guides your future actions. Many utilities at this stage will adopt a new or confirm their existing mission and vision.

### Engage all your stakeholders

After your leadership and staff have rallied around a common mission and vision, it is time to align other key stakeholders, including customers. Employ this tactic early and often.

Gaining input involves more than surveys about rate proposals. You want to open a dialogue about stakeholder priorities and perceptions, which help you determine courses of action most likely to secure buy-in. Discussions could

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include your community's urgent water needs or customers' knowledge of what it takes to achieve current service levels and their opinion of rate changes.

Organizing a stakeholder committee, sometimes referred to as a “blue ribbon committee” or “stakeholder advisory committee”, is an effective approach for managing stakeholder communications through long, what can often turn out to be, multi-year planning efforts. This committee should represent the diverse perspectives of your stakeholders, and committee members should pledge their commitment for the duration of the planning effort. The most effective stakeholder committees have strong internal leadership, organization and planning skills, an openness to learn and hear different viewpoints and the courage to make tough decisions.

Be careful to manage expectations—draw clear boundaries around what you will and will not do and recruit partners for help when possible. Encourage input but remind people that not every idea can make it to the final plan. Finally, respect members' participation—remember these committees are made up of volunteers so be respectful with people's time and effort.

Now that you have a clearer vision of your agency and stakeholders, it is time to lift your head and look further down the road.

## STEP 2 CREATING YOUR ROADMAP (MASTER PLANNING)

You will sharpen your foresight by merging your information into a long-term master plan—a roadmap that will guide you through every major decision.

Since your master plan will include project and financial forecasts several years into the future, everyone can look to it as a touchstone, whether to anticipate needs, determine priorities or help answer major questions, including:

- What is the current condition of our assets?
- What do customer and consumption growth look like over the decades to come?
- What are our growth related capital needs down the road?
- What are the biggest renewal and replacement projects?
- What will we need to pay for these projects?
- What will the CIP cost if it's started now or in five years?
- What process will we use to prioritize capital needs?
- How will it impact our operations?
- What are the benefits of related rate increases?

### **Targeted communications**

Whether striving for partner buy-in or laying the groundwork for a vote, agencies need to tailor communications for each audience.

Some agencies devote significant time to understanding cultural backgrounds and effective community communications practices of their customers, including when and where they would most likely attend public hearings. Increasingly we are seeing the need for public communication to take place in multiple languages; think about engaging a public relations specialist to address these specific needs. On a municipal level, meeting with a city council's public works subcommittee might be a first step.

- How fast can we go given stakeholders' appetite for change?
- Will the agency staff need new skills and how does that fit with the aging workforce?
- Which additional resources are needed to finish this work?
- What process should we use to validate our rate assessments?

In some states such as Washington, state law mandates the preparation of a master plan every five years; others states may not have such a prescriptive requirement. Nonetheless, master plans are keys to building a foundation for gaining support to secure your utility's financial future. It is the "evidence" you will need to convince stakeholders, again, both internal and external, decision-makers and ratepayers, that current and future rate adjustments are needed to secure your financial future that will enable you to fulfill the mission of the utility.

### Address large, looming issues

Where do you stand with earthquake preparedness? What steps are you taking to mitigate the effects of climate change on water supply and delivery? What are the emerging issues and does your utility have the flexibility and resources to address them? What does your future workforce look like?

While you have your team's attention focused on the long term, take some time to examine your agency's resiliency planning, succession planning and larger regional projects that are becoming more common.

## STEP 3 SECURING YOUR FINANCIAL FUTURE

### Always look ahead

Of all the people who buy new houses, very few will put away 2 – 3% of their money in the early years to cover a new roof, furnace or other major replacement down the road. However, water agencies who keep depreciation in mind are better positioned to replace their aging infrastructure while maintaining financial security.

Even if your agency only allows for annual or biannual rate adjustments, agencies can alert the council and public to upcoming infrastructure needs by presenting a five-year or more outlook. This allows customers, whether you are a single-family or large business, to plan their own long-term budgets and ensure their financial security.

This type of foresight does not match legislative or election cycles, which makes it a heavier lift, but the public values it. Case in point: An amendment to the



### Bring “out of sight, out of mind” into view

During the preparation of a water master plan, the utility general manager (GM) presented the results of the water master plan at numerous community meetings and carried around a 1-foot section of corroded pipe to show customers the condition of the water system. It was a compelling viewpoint that helped build support for the ultimate approval of two 32% rate increases over a 5-year time period—significant rate increases, but necessary to support the results of the master plan and ultimately secure the utility's financial future in meeting their mission.



City and County of Honolulu's city charter requiring city departments in charge of infrastructure to prepare long-term plans passed with 80% of the vote this past November.

### **Tell a story with metrics**

Preparing a financial model for baseline operations leads to the next step: proposing a change to operations and showing its effect on rates. Then you can share a narrative: This is where we are now, here's where we're going to be.

If you're behind on infrastructure replacement and learn that the capital budget should be \$4 million per year instead of \$1 million per year as a result, your story will point out the benefits that results from spending the higher level of capital and the various ways to finance those projects. That is how you change the dialogue and build confidence in and acceptance of your financing plan.

When it gets down to revising rate structures, there are a couple of current topics garnering interests from water utilities, including finding the right balance of recovery of fixed and variable costs through rate design and the impacts of a recent California rate case, *Capistrano Taxpayers Association v. City of San Juan Capistrano (2015)*. The first topic is one that is getting more attention as utilities try to stabilize revenues, especially in areas stricken by drought. While the second topic seems to be California-specific, the takeaways from this decision have implications for all water utilities as the decision required California water utilities to use actual cost bases for setting multi-tiered volume rates.

### **Explore debt as a valuable tool**

By taking a 360-degree view and asking the right questions, not just following a formula, agencies can find the fairest ways to spread the cost of infrastructure improvements. The two most common sources of paying for infrastructure are cash financed (through rates) and debt financed. Right now, the rates for municipal borrowing are at their lowest level ever, so that remains attractive. Still many utilities are debt averse, preferring to "pay as you go" and cash-finance nearly all capital improvements.

Remember that we are mostly talking about financing long-lived assets—assets that will provide benefits to generations of ratepayers. Shouldn't future generations pay their "fair share" instead of burdening current ratepayers with the upfront costs? By using debt to finance a portion of replacement needs, you are aligning the benefits of the new assets with the people who are going to benefit from them down the road.

Even if some debt financing approaches have been rejected before, there are innovative ones to examine or combine: The District of Columbia Water and Sewer Authority recently used 100-year (century) bonds; some states have financed sustainability projects with "green bonds"; and others have used

### **New loan program on the horizon**

The federal government is preparing a new tool to help you finance infrastructure investments. The **Water Infrastructure Finance and Innovation Act (WIFIA)** authorizes the EPA to provide long-term, low-cost loans at U.S. Treasury rates for up to 49% of eligible costs for projects of over \$20 million for large communities and over \$5 million for small communities (populations of under 25,000).

As of December 2016, the EPA is getting ready to implement this pioneering program to accelerate investment. WIFIA is structured to work hand-in-hand with the State Revolving Funds program, allowing states and prospective borrowers to choose the best one for the project or use the two programs together.

President Obama's FY17 budget proposal called for a \$20 million investment in WIFIA, which—because of its inventive structure—would be expected to support nearly \$1 billion in loans for new water projects.

public-private partnerships and risk-sharing between municipal utilities and private companies. These approaches provide more options to close longstanding funding gaps.

## Find common ground

Even with a master plan in place every five years or so, you should still seek input from others often. Stakeholders' ongoing investment in the process should accelerate your implementation of the right solution. Once they understand your roadmap, you can work together to resolve any issues and reach the most mutually beneficial agreements in a timely manner.

In one agency, a water rate study revealed that large customers such as hotels and industrial customers were eager to improve water service reliability and were willing to sign on for rate increases necessary to provide this higher level of service. After all, a water main break posed a tourism nightmare. Yet local seniors said they could not afford the proposed hike.

If these two competing voices talked to council members, the rate proposal may never have gotten traction, but the agency's consultant negotiated a solution: hoteliers offered to shoulder more of the increase to unburden the seniors. The process required modeling the impacts correctly, showing the effects and striking an agreement before bringing the solution up for a council vote. The rate proposal passed in classic "win-win" fashion.

Clarity on the issues makes progress possible.

## Raise Your Planning Standards

Water agencies of any size can successfully reach the Gold Standard in planning. The process positions agency leaders and other stakeholders to realize positive results in the near and long term.

If any part of the approach seems daunting, reach out for help. A skilled consultant can help you put the pieces together and prepare your agency for whatever the future may hold.



### About the Author

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Ann has collaborated with water, wastewater, electric and solid waste utilities for 30 years on financial planning, rates and best practices for utility planning and operations. As a result, she's familiar with the most pressing issues facing utilities today: aging infrastructure, capital financing, cost recovery via user fees and the need to balance conflicting stakeholder needs and wants.

Ann dealt with these issues during her tenure as client services manager for the Hawaii utilities market and her recent stint as the client services manager for the King County Wastewater Treatment Division in Seattle. She also led client management and sales efforts for other clients in Washington state and Guam. Her approach helps clients perform better, save money and meet or exceed stakeholder expectations.

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