

IAMU CONNECTION

Vol. 4 No. 3 Fall 2019

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A Focus on Finance



Rate Setting & Fiscal Planning for Water Systems

Glenn Barnes, Director of Water Finance Assistance, will hold a series of free workshops around Iowa, including two at the IAMU office, in October. He plans to discuss rate setting and fiscal planning for water systems, particularly smaller systems. IAMU was able to talk with Barnes to get background on what he plans to include in his workshop. Here is the Q&A from that conversation.

Question: When it comes to rate setting and fiscal planning, what are the best practices that utilities should consider or should adopt?

Answer: The rates should really reflect the cost of providing drinking water today, but also into the future. In my experience of working with water systems for more than a dozen years around the country, most systems can cover the day-to-day costs of running the system but do not necessarily anticipate the long-term system needs. Ideally, there would be some type of long-term system plan like an asset management plan, or a capital improvements plan, or both so the system can understand when it will be necessary to replace assets. Be more proactive than reactive in terms of managing infrastructure.

A strategy of “We are going to keep the rates as low as possible, and we’ll barely cover the day-to-day costs; and if something breaks, we’ll then think about how to pay for fixing or replacing it,” is not really a great, attainable strategy. Ideally, there is some thought into anticipating when those changes are going to happen.

Long-term planning is in large part about assets that you own currently or those that you might need in the future if you’ve got new business or industry coming in, new population

coming in, or changes in regulation. You have to pay attention to your demographics because I would suspect that in small Iowa towns, much like small towns around the country, they’re seeing pretty significant demographic changes with populations getting older and smaller. In long-term water system planning, you must understand that you may need a different system in the future than you had in the past. That is another piece of this.

Question: When is the best time to tackle rate setting and fiscal planning?

Answer: Long-term planning and the asset management process should really be continual. You should look at and bring in information about assets on an ongoing basis. When it comes to rate setting, I really encourage water systems to at least review rates annually as part of their budget process. Systems may review rates and find that they will be sufficient for the upcoming year, that no changes are warranted, and that’s fine. Systems don’t have to change rates every year, but systems should really look at them every year and make changes when necessary.

Question: What new trends are we seeing when it comes to setting rates and fiscal planning?

Answer: Data-driven decision-making and community priority-driven decision-making are two things that are new or different considerations that water system can have that can make the process a little bit better. We’re seeing a trend and encouraging water systems to use data to help drive the decision-making process around rates and some utility policies. That could be measuring the financial

health of the water system by calculating key financial ratios. That could be asset management. That could be doing a non-revenue water audit, and using data to help make smarter decisions about the utility and what to expect going forward.

I think that’s again where the demographic changes are going to come into play to some extent. If you start with the mindset that the water system is there to serve the community, then you want to ask the question, “What does the water system need to do to best serve our particular community and beyond just having that appropriate level of revenue?” There may be other priorities that you have depending on demographics. For example, affordability may be a big concern for a community. “Are we setting rates for both the structure of the rate and the price of water in such a way that it meets the needs of that affordability priority for the community?”

It could be that economic development is a priority. “Is water being priced in such a way and the water system set up in such a way to support economic development goals?” The rate structure and levels and the system’s financial health can be ways to support broader community goals.

Question: Who should be involved in those rate-making and fiscal-planning processes?

Answer: It’s a big group. When you’re talking about this process, you should really involve the different people touching the various aspects of running the system. You have operators and system managers responsible for the day-to-day running of the system. They are going to have the best understanding of how the

system is doing and what is needed on a day-to-day basis for the system to meet its goals.

Now, you're also going to have municipal staff. This could include the town manager or clerk and budget or finance officers who must ensure the system's financial health and how that system fits in with the overall town budget. Even with a system being an enterprise fund, that town manager or that top staff administrator is responsible for pulling together the budget, looking at what the rates should be, and making that proposal to the board. The board ultimately sets the rates and makes those final decisions. So, all of these folks need to be involved to some extent.

The other group that I want to mention is towns may want to look for outside help when considering their rates, financial health, and asset management. There is a universe of private consultants who do thorough rate studies. Then, you've got technical assistant providers like me to help, in particular smaller communities, through these processes. The technical assistance complements what the private consulting world does. These outside experts can be really helpful in giving a fresh perspective, bringing their expertise from working with other systems, and expressing the need for potential rate changes or increases to the board. These consultants are a disinterested third party coming in saying, "Well, we did this analysis and this is what it says." Again, that ties back to that data-driven decision-making idea.

Question: Are there any new or different considerations that utilities should keep in mind when setting rates and/or engaging in fiscal planning?

Answer: One piece of asset management is what water system level of service to provide. Meeting

“ A lot of people take for granted turning on a faucet and water coming out on demand. They don't really give it a second thought. The fact that you're getting that water on demand, and that there is a very, very, very, very low chance that it will kill you is an incredible marvel that 150 years ago would have been mind boggling to people.”

**– Glenn Barnes
Director of Water Finance Assistance**



the Safe Drinking Water Act requirements and other regulations is the minimum level of service. That should be a given.

You can have water that tastes bad, smells bad, looks bad, doesn't have good pressure, and stains your clothes in the washing machine, but is perfectly safe. It meets the Safe Drinking Water Act requirements; but aesthetically, it's not very good. I'm somebody who if I get in the shower in the morning, I want good water pressure. That has nothing to do with how healthy the water is; but as a customer, that's probably something that I would complain about in my town if I wasn't getting it. The community needs to be able to express in some way what it's really wants with some of these aesthetic water qualities.

On the flip side, the community also must understand that may impact price. If you want a higher quality water than you're getting, that may be possible; but it may be more expensive. If you want leaks fixed faster than they are currently being fixed, that's good feedback to have; but it may be more expensive to provide that extra service.

Question: How does a utility communicate financial-related activities and decisions to the general public, knowing that the average person doesn't have a background in either finance or utilities?

Answer: A lot of people take for

granted turning on a faucet and water coming out on demand. They don't really give it a second thought. The fact that you're getting that water on demand, and that there is a very, very, very low chance that it will kill you is an incredible marvel that 150 years ago would have been mind boggling to people. People, for thousands of years, have had an amazing understanding of how to move water where it was needed, but getting that water to be safe to drink is relatively new in the last maybe 120 years. We have been so good at doing what we do in the utility field that modern-world people take it for granted. That's why something like what happened in Flint is so shocking.

People who work on drinking water every day understand the enormous effort that goes into procuring, treating, and delivering water; and the amount of infrastructure that is needed. It's easy to forget that the average person really doesn't understand that at all. I always encourage people in the water sector to talk about what they do. When you go to a barbecue, tell people what you do, talk about how important it is. It's great when utilities can give treatment plant tours. Start from the idea that most people take water for granted and don't necessarily understand all the work that goes into it. Then, layered on top of that, it's really hard to get people to want to pay for something if they really don't understand what they're paying for. Some of the work that I've done with communities – and some of the best practices that I've

seen – is just doing small things like getting an article in the local paper or using social media whenever a repair is happening. Talk about how you're using residents' money, how you're fixing the infrastructure. Explain how users might be impacted while you're doing the work. For example, you might alert residents that you must close a street for a day or two and what the eventual benefit will be. That isn't the final answer to this communication problem, but it's a start. It's important to talk about how the water system serves the community and how a community couldn't exist without a functioning water system.


This is a little bit overly dramatic, but it's something I recently heard: If the water system were to fail – and let's assume the water system fails and there was no ability to get bottled water or to get outside water in any way – all of us would be three days away from dying. When you actually hear that, it's shocking. Taking advantage of opportunities to talk about your water system through media, public events, or one-on-one communication is really helpful, but focus on how the water system

benefits the community at large and individual people. Making that connection is going to help customers and citizens to be more accepting of needed rate increases when they come.

People who work in drinking water have as much to do or more to do with public health than doctors and nurses do, but many people don't think about drinking water operators as being public health officials. They are a largely crucial but underappreciated group in modern society. We need to change that. That awareness impacts the ability to charge appropriate amounts for water.

Question: Is there anything that you would like to add or think IAMU members should know about rate setting and fiscal planning?

Answer: There's this idea among some communities that I've worked with to keep rates low for the sake of keeping rates low. Some communities will even brag about how long it has been since they've raised rates. Part of the rate-setting and fiscal-planning challenge is to have pride in having

a system that functions well, is well invested in, will be around for generations, and is serving a vital need in the community. It's a different way of looking at things, but we've got to get away from this idea of being excited any time rates aren't raised. We need a mindset of "I take pride in knowing that the rates are what they need to be to run the system today and into the future." Citizens and voters will appreciate the fact that you are making smart decisions even if it means rates will have to go up. It's easier for citizens to pay a small increase in their rates annually than to not have an increase for 10 years and then a 25 or 35 of larger percent increase in a single year. You have to be cognizant of that fact. Rates are going to have to go up at some point in the future – given inflation, given the changes and increases in regulation, and differences in treatment technologies. Ignoring that fact is only going to lead to a system putting itself in a bad position where it might be endangering people's health because it's not working very well or where it's going to be in a bad financial position and is going to have to see a rather painful course correction in the future. 

IOWA DRINKING WATER RATE SETTING WORKSHOP SERIES

October 15-18 at locations across the state

Your water rates are the most important source of revenue for your water system. Are your rates sufficient to cover the cost of providing water service today and into the future? And are your rates structured in a way to best meet the priorities of your community?

This FREE workshop will explore several important aspects of water system finance. Anyone involved in the financial management of your water system is invited to attend, including board members, town managers, budget and finance staff, utility managers, and operators. The workshop is geared toward small water systems. We welcome multiple attendees from the same community.

The content will be the same at each workshop. Please choose the day and time that works best for you.

- ◆ Tuesday, October 15: North Liberty Water Treatment Facility, North Liberty
- ◆ Wednesday, October 16: Newton Des Moines Area Community College, Newton
- ◆ Thursday, October 17: Iowa Association of Municipal Utilities, Ankeny
- ◆ Friday, October 18: Iowa Association of Municipal Utilities, Ankeny

All workshops will run from 8:30 a.m. to 4:00 p.m.
To register, go to <https://www.waterfinanceassistance.com/iowa>