

Appendix N.

Case Study on Integrated Rate Design and Communication

Prepared by Moulton Niguel Water District for the 2015 Urban Water Management Plan Guidebook.

N.1 District Background

Moulton Niguel Water District (MNWD) provides water, wastewater, and recycled water services to approximately 170,000 people within the Cities of Laguna Niguel, Laguna Hills, Aliso Viejo, Mission Viejo, and Dana Point in South Orange County. The MNWD service area is 100 percent dependent on imported water from Metropolitan Water District of Southern California.

The annual potable demand is approximately 29,000 acre-feet, and 25 percent of total demand is met from the reuse of imported water. MNWD has been very proactive in conservation and water use efficiency over the years. Fiscal year 2014–2015 (the District is on a July to June fiscal year) has the lowest potable water usage on record since 1991.

The total annual budget (including operations/maintenance and capital improvement projects) is \$126 Million for fiscal year 2014–2015. The key sources of revenue are generated from water, wastewater, and recycled water rates and ad valorem property tax. MNWD has a strong financial position, receiving an “AA+” rating from Standard & Poors and “AAA” from Fitch, two leading credit rating agencies. Unlike most water agencies in California, MNWD has not increased its rates at regular intervals, having only seven rate increases over the last 30 years.

N.2 Historical Tiered Rate Structure and 2009 Drought Response

Historically, MNWD has had a tiered rate structure with five tiers and have had a modest price increase from Tier 1 to Tier 5. In 2009, MNWD sought to aggressively respond to drought restrictions and consequent wholesale allocation reductions from the Municipal Water District of Orange County

using an enforcement-oriented approach. Mandatory drought watering restrictions were enforced, and violators were issued fines after several warnings. To manage this effort, MNWD increased its staffing by approximately 12 full-time employees and issued approximately 20,000 warning letters and violations. One result of limiting the days customers could water is that some customers overwatered on the days that they were allowed to irrigate, nullifying the District's attempt to save water. Additionally, the enforcement effort resulted in customer backlash because of resentment of the District acting as "water cops," and was perceived as telling customers how to manage their own private property.

N.3 Changing to Water Budget Based Rate Structure

The decision to adopt a water budget-based rate structure (WBBRS) was a result of MNWD's experience in 2009 with mandatory restrictions. Implementing a WBBRS has resulted in a more efficient use of water. An econometric modeling study in 2014 demonstrated that MNWD's WBBRS accounted for an approximate 20 percent reduction in water usage since 2007, the year that the District experienced the highest water demand in its history. At a public hearing in February 2015, MNWD adopted the new WBBRS, which included rate increases for the next three years.

N.4 Planning for the Rate Change Process

MNWD began to evaluate increasing and restructuring its rate structure in March 2014. However, the planning and preparation started much earlier. To prepare for future rate increases and rate structure modifications, MNWD involved staff from all levels of its organization. In addition to internal feedback solicitation, MNWD sought input from customers and communities to identify areas of improvement for the future. MNWD evaluated numerous aspects of the rate implementation process to ensure the WBBRS's success, including planning, roll out, internal and external communication, public education, timing of rate adoption, financial implications, legal considerations, creating clear messaging, and providing ongoing resource needs.

MNWD also looked at other agencies' experiences with their own rate structures to see what could be learned. MNWD paid close attention to litigation and legal opinions, including the Capistrano Taxpayers Association v. City of San Juan Capistrano case, a suit which had been filed against a

neighboring city. Based on MNWD's experience and others' experiences, MNWD knew that not only did it have to meet the legal requirements of the Proposition 218 process, but had to make sure that the public could understand what exactly was being proposed with future rates and the need to establish a comprehensive administrative record that described and clarified the rate setting process. MNWD needed to understand the impacts to customers, have clear rationales to justify the changes, and have extensive outreach to ensure a successful rate adoption.

Another important step that MNWD took was to bring rate analysis expertise in-house rather than relying on consultants every three to five years when rates are typically reviewed. The in-house resource has allowed for ongoing monitoring and evaluation of the rate structure which has allowed for continuity and flexibility in responding to changing conditions and financial needs.

N.5 Customer Communication

When Governor Brown declared the drought emergency in January 2014, MNWD saw it as a great opportunity to increase awareness and focus the public interest on water to help implement good policy. MNWD knew that its customers held a high value for water because of its scarcity, and the timing was right to further promote water efficiency and to prime customers for future needs and ensure a reliable water supply.

Additionally, MNWD was able to utilize the water efficiency funds, which are collected from inefficient users in the over-allocation tiers, to partner with cities and school districts on large turf-removal projects and provide several million dollars in funding to create long-term savings and encourage behavioral shifts to less thirsty plants. These visible partnerships helped the customers understand the value of WBBRs in allowing MNWD to invest in its communities and help them respond to the drought.

In addition, MNWD wanted to implement its new rates in spring rather than summer. Rate increases/changes during summer, when water usage is at its highest, could result in significant increases to customer bills; instead, in the cooler season, the customers have a chance to get accustomed to the rates and adjust their usage accordingly.

Adding to the momentum, when the State Water Resources Control Board

(SWRCB) mandated the drought emergency regulations, MNWD saw an unprecedented level of public attention to water statewide. This interest provided yet another opportunity for MNWD to demonstrate the value of WBBRS to its customers. Part of the emergency regulations required enforcement of restricted watering days. Based on MNWD's 2009 experience, the district knew this approach would be counterproductive in its service area. MNWD communicated its concerns to SWRCB and were allowed to submit an alternate plan, which was approved and allowed MNWD to continue with its water efficiency programs and plans to further its efforts. This was a great message to MNWD customers who appreciated being able to take responsibility into their own hands in conserving water. Customers also recognized WBBRS as an effective and sustainable tool to manage demand. MNWD was only one of two agencies in the state to have its alternate plan approved.

N.6 Incorporation of a Water Shortage Contingency Plan

MNWD's new rate structure includes the ability to respond to drought conditions by incorporating a water shortage contingency plan (WSCP). The inclusion of a WSCP allows MNWD to modify allocations during times of droughts or other emergencies without conducting another Proposition 218, resulting in the ability for more immediate action when it is needed. Additionally, the gallons-per-capita-per-day indoor factor and the plant factor for the outdoor water budget were lowered in the normal condition rate structure to further encourage long-term water efficiency in the district.

N.7 Long Range Planning Effort

MNWD knew that having a long-range financial plan that forecasted the district's need for the next 10 years would serve as the foundation for any future rate discussions. Also, a better understanding of reliability projects based on the service area's future needs would help to define the required funding to ensure continued reliability. Staff and consultants worked together to develop a long-range water reliability plan to study future demand, risks associated with system and supply, and potential projects that should be considered to enhance reliability. MNWD also revised its reserve policy to ensure that reserve targets and funding levels were designed to offset current volatility to mitigate risk in the face of drawing down reserves. Part of the plan included utilizing funds from the reserve to mitigate the short-term rate impact.

N.8 Project Team

When the official rate review started, the first step was to build a strong team. MNWD knew from the past that involving staff members from various departments and from all levels was critical to success. It was important to understand the experience and insight of customer service representatives who dealt with customers daily, the conservation group, and finance and management. In addition to gathering in-house rate experts, MNWD also hired a consultant to work with staff to ensure a comprehensive effort. From day one, MNWD involved a legal advisor who is an expert on Proposition 218, Article X of the State Constitution and the legal precedents for water utility rates. Legal review and guidance occurred every step of the way to ensure a justifiable and defensible cost of service and rate design. The finance group worked with a financial consultant and across all levels of staff and departments to develop a detailed and comprehensive cost of service, which led to a rate design that will strengthen the financial stability of MNWD while incentivizing water use efficiency.

The team closely reviewed MNWD's existing rates, identified lessons learned, and researched various legal cases against rates so that the district knew what pitfalls to avoid in structuring its rates.

N.9 Crisis as Opportunity

Some agencies thought that increasing/modifying rates during a drought emergency would create additional challenge in garnering public support. MNWD saw it as an opportunity to showcase how well WBBRS works and the benefits of the rate structure for the community. The fact that the price of water increases during drought when supply is scarce made sense to the customers.

MNWD also utilized news stories about major line breaks because this information reminded the public of the importance of repairing and replacing infrastructure now to avoid even greater costs in the future. MNWD helped its customers understand that water purchases and capital improvement projects are the major drivers of rising costs. The need to spend money to maintain infrastructure to avoid major failures that cause service disruptions and significant damage to private properties was also understood by MNWD's customers.

N.10.1 Legal Guidance

Having legal guidance and involvement throughout the process was critical. Having the team understand the legal implications as well as having legal counsel familiar with MNWD and its operations made the process collaborative, resulting in everyone working together and ensuring buy-in every step of the way. The approach also gave the Board of Directors the assurance that MNWD was going above and beyond the minimum to develop a rate structure that supported the district's needs and could withstand any potential legal challenges. The cost of service study and rate design consisted of more than numbers and technical information to support the proposed rates. The importance of having a comprehensive and extensive administrative record was clearly demonstrated by various legal challenges so the approach to the cost of service study was to make it clear, easy to understand, educational, and informational. Those who criticize and decide on the merits of rates are not water experts; because of this, it was critical that the supporting material of the rates were developed and written so that anyone could review and understand the material. The same philosophy applied to the Proposition 218 notice. Rather than simply taking the legal minimum requirement approach, the notice included information about the drought to provide context for why the rates were being proposed. The assistant general manager was listed as the contact in the notice. That way anyone who called with questions or concerns would not be routed to different departments based on their needs; in addition, with each call, MNWD would take advantage of the opportunity to help better inform customers about various water-related issues. Staff also met with customers interested in addressing concerns of the rate changes.

N.10.2 Importance of Customer Outreach

Though customers may not be happy with the rate increase, they were very appreciative of the level of customer service they received. Customers who had received this high level of service complimented the district on the way it handled the rate process during the rate hearing.

MNWD remains committed to early, proactive, and frequent communication with its customers, and it realizes the importance of well-planned outreach on rates. Leading up to the rate review, the district built positive relationships with cities, civic groups and community-based organizations. These relationships were integral in establishing trust, which is invaluable when raising rates. When it started the rate study, MNWD went to the cities

it serves and presented to both city council and city staff. MNWD also incorporated its plans for the rate study to its speaker's bureau program and every speaking engagement staff attended over the course of the study. MNWD met with the cities and its highest water users to help them understand how the rate increase and structure change would impact their bills. To provide transparency, MNWD held numerous board meetings in a public forum to discuss its plans and progress during the rate study. The board was given a monthly update on the rate study to help facilitate focus and discussion on rates at future meetings and workshops. MNWD's Citizens Advisory Committee (CAC) was also updated and provided obtain feedback, and CAC members could help spread the word to various community contacts. Several CAC members spoke in support of MNWD at the public hearing. MNWD continued to communicate with its customers to ensure that they received all the information they needed. MNWD's customers appreciated this outreach efforts and applauded the district's commitment to transparency.

N.10.3 Public Hearing

MNWD's diligence never stopped. Leading up to the public hearing, MNWD received 16 letters of protest from the 170,000 people it serves. Even with so little protest, MNWD planned for the public hearing. The board president, who presided over the hearing, was given a script developed with legal counsel that included all the pertinent information. The team had their roles in presenting the information as well as responding to the board or members of the public. At the day of the meeting, approximately 30 members of the public attended, and many came to support the new rates. Of the 13 people who spoke, only four expressed disfavor of the proposed rate increases. The hearing concluded with the board adopting the proposed rate structure, which took effect April 1, 2015.

N.10.4 New Rate Structure

Moving forward, water demand management continues to be regarded as MNWD's core function. MNWD has restructured its organization to enhance integration of all departments to center around demand management as a district-wide responsibility and commitment, not just something that management and conservation departments are tasked with. The new water rates ensure the following:

- Those who place the greatest demands on the system pay for the cost associated with that demand.
- Those who use water inefficiently pay at a higher rate than efficient users to collect the proportionate cost of efficiency programs to maintain a reliable water supply for all.
- The funds from higher rates are used to further incentivize efficient use and support demand management strategies.
- In times of drought or other emergencies impacting supply, inefficient users are first to be penalized under the water shortage contingency plan.
- The water shortage contingency plan is integrated with the rate structure to avoid the necessity of a new Proposition 218 notification to change allocation in a drought or other emergencies to be more responsive and adaptive.
- The water shortage contingency plan was adopted as an ordinance to allow for penalties to be applied for the inefficient use of water.
- Wholesale costs for imported water and sewer treatment are built in as a pass-through for the next five years.
- Fixed-cost recovery is achieved, improving financial stability regardless of water sales.
- A rate structure that is more effective and cost-effective for MNWD's service area in promoting efficient usage is better than enforcing mandatory water restrictions.

The complete rate study is available on [Moulton Niguel Water District's website](#).

N.11 Looking Forward

MNWD plans to have ongoing discussions with its customers about rates; the more the district communicates and reviews, the better everyone can understand the importance of water and rates. MNWD is already preparing for the next rate study by doing additional planning, including a comprehensive asset management plan. The district continues to build on the relationships and partnerships in its region and participates in statewide efforts to encourage the public's understanding of rates.

Despite litigation challenging rate structures, particularly the ones involving budget based rate structures, MNWD has had a positive and successful rate hearing process. The success of the recent rate adoption is credited to the staff who turned crisis into an opportunity by applying valuable lessons learned, tackling challenges with enthusiasm and creativity, while dedicating themselves to earn the respect and trust of the customers.

Every agency is different because the communities and customers served are unique. There is no one-size-fits-all strategy or structure. Knowing customers' needs and having relationships in place are what makes any rate review successful. Rates should not be reviewed or discussed every handful of years; rate considerations involve constant discussion and this effort provides an ongoing education for MNWD and its customers.