

NC Currents

THE OFFICIAL PUBLICATION OF
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SUMMER 2009

WATER INDUSTRY FINANCING

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UTILITY FINANCING CONFUSION

By Mary Tiger, Environmental Finance Center at UNC

Customer confusion about utility financing can become apparent when utilities try to pass rate increases. In the face of this confusion, utilities often struggle to justify higher rates – a challenging task, especially when customers have not experienced any problems. As far as customers know, they turn on the tap and water comes out; they then flush the toilet and waste goes away. Indeed, utilities may have actively sought for customers not to think about their utilities, and for many years, water and energy providers were content to ‘fly under the radar.’

Unsurprisingly, many participants in a recent study of Charlotte-Mecklenburg Utility (CMU) customers were mystified about why drought surcharges would ever be needed. The root of their bafflement was a misunderstanding about their utility’s finances.

When utility customers and the corresponding governing body does not understand a rate increase, they may be more likely to oppose it and put the utility in an undesirable situation. Given that 79% of North Carolina utilities have changed their rates over the past two years (as referenced in the article entitled “How Many Utilities In NC Are Raising Residential Rates & By How Much”) and that these trends are expected to continue, customer confusion has the potential to cost utility managers and staff a lot of time and pain.

Financial Confusion

In November of 2008, the Environmental Finance Center, with support from Charlotte-Mecklenburg Utilities and the North Carolina Public Water Supply Section of NC DENR, conducted four focus groups with Charlotte-Mecklenburg Utility customers to gauge customer understanding and support of a proposed drought surcharge.

These focus groups revealed a lot about customer perception and knowledge

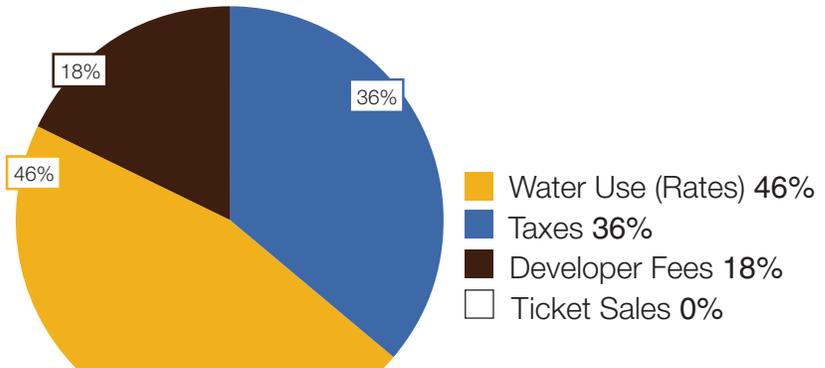


Figure 1: Customers answers to what the primary source of revenue is for utilities (data collected from 28 focus group participants)

of utility finances. Although the focus of the research was not to discuss utility financing, participants naturally commented on it and questioned why such a rate was needed, how revenues would be used by the utility, and what were the salaries of utility staff members.

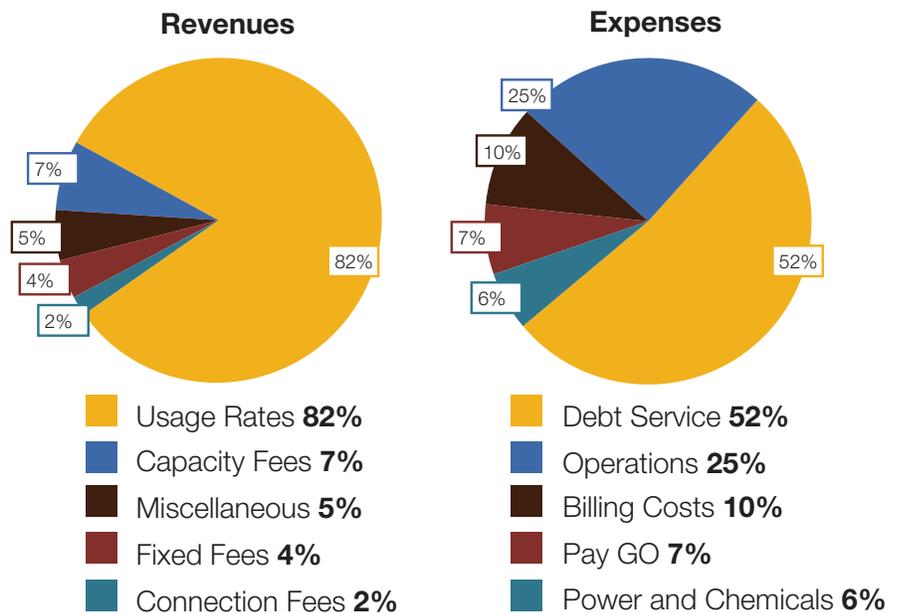
The most common questions that emerged from the four focus groups were, “Where do utilities get their money?” and “Whose pockets am I lining with my bills?”

“Where do utilities get their money?”

Participants in the focus groups were unclear about the primary revenue source for Charlotte-Mecklenburg Utilities(CMU).

CMU, like most utilities, collects the majority of its revenue from water usage (i.e. the collection of water and wastewater bills). When asked to identify CMU’s primary revenue source from a list including taxes, water use, developer fees and ticket sales, only 46 percent of the customers participating in the focus groups correctly answered water use (see Figure 1). On the other hand, 54 percent of these customers said either developer fees (18 percent) or taxes (36 percent) were the cause. This type of customer confusion could be a major hurdle in communicating the need for rates like drought surcharges.

Figure 2: Revenue and Expenses for Charlotte-Mecklenburg Utilities in a given year



Source: CMU Director Doug Bean’s presentation to Charlotte City Council on December 1, 2008

“Whose pockets am I lining with my rates?”

Some focus group participants did not believe that utility expenses could actually increase when water usage decreases. This type of thinking might have countered their logic that conservation saves the utility money. Therefore, in customers’ minds, a drought surcharge would only add additional revenue for the utility, and that it would be ‘icing on the cake’ or, as one participant phrased it, “bonuses for bureaucrats.” In addition, focus group participants asked, “What are the surcharge revenues being used for?” There seemed to be a general feeling that customers wanted the surcharge to be used for the ‘good.’

Figure 2 (see page 49) shows the general breakdown of Charlotte-Mecklenburg Utilities’ revenue sources and costs; where the money comes from and goes to. The gray line items are relatively fixed and do not fluctuate based on how much water the utility sells. The blue line items vary significantly based on how much water is produced or sold, and can vary drastically especially in a drought. As

consumption declines, the utility’s revenues drop significantly, but the utility’s costs remain relatively unchanged.

Other questions raised by focus group members included:

“What do you mean the utility is not run for profit?”

The fact that the utility, owned by the local government, was not-for-profit surprised some customers.

“How do I know that they are doing the right things with my money?”

Not all focus group participants trusted that the surcharge would ever go away. They felt like they had no way to monitor what the utility was doing with their money.

“What are they doing with the money they already have?”

And of course, a predominant question was about the utility’s financial

efficiency. Many wanted to know whether the utility was resourceful with the money it already had.

What This Means

If customers and citizens are not aware of how their utilities finance their operations and maintenance, they may perceive any rate increase as unfair and objectionable. Strategic communication between utilities and their customers can alleviate resistance and help ensure financial stability. The financial story of a utility will not be conveyed quickly or easily, but ‘a journey of a thousand miles begins with one step.’ 

About the author:
Mary Tiger is a Project Director for the Environmental Finance Center at the University of North Carolina and provides outreach services to local communities on water conservation strategies and sustainability.

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