



## MEMORANDUM

**TO:** Mayor & Council

**FROM:** Marc A. Ott, City Manager 

**DATE:** March 27, 2014

**SUBJECT:** Austin Water Utility Business Model

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The ongoing drought has obviously created many challenges for our community. With the Highland Lakes' current storage level at only 38% full, we all understand that this precious resource is in critical condition. That being said, the drought has also resulted in several positives as our citizens continue to support Austin Water Utility's (AWU) long term conservation efforts. For example, one of our primary conservation efforts, outdoor watering restrictions, has helped to dramatically reduce our per capita water consumption. In fact, over the last 2 years, the Utility has experienced per capita water use lower than the average 140 gallons per capita per day goal the Council directed the Utility to achieve by 2020. We believe that this consumption level should be considered as the "new norm" as the drought persists (Austin is entering its 3<sup>rd</sup> year of Stage 2 - one day per week water restrictions). Given the duration of the drought, we believe that a significant portion of these water reductions will be permanent even after reservoir levels recover and we lift out of Stage 2 restrictions. If the drought continues to persist, Austin will be required to implement additional water restrictions.

With that backdrop, I believe that it's time to review the Water Utility's business model. As you know, AWU's rate structure is based on a mix of flat customer/minimum charges and volumetric charges. This structure emphasizes the volumetric charges...in other words the Utility counts on the volumetric charges to fund most of its expenses. Over the last few years it's been clear that the volatility of these volumetric charges place the Utility in a challenging fiscal environment. The Utility has many base costs that aren't dramatically impacted by how much water it treats and delivers to customers. However, with the current structure emphasizing volumetric rates, these costs are not being funded adequately. Although decreasing use does lower some of the Utility's costs, the decrease is not equal to the drop in revenue seen via the current rate structure.

**A New Business Model** - The current business model is proving to be unsustainable. It places the Utility in a financially challenging position while also creating a dichotomy of sorts...the Utility is promoting long term conservation but with the current rate structure dropping, consumption will not fund base expenses. Of course, facing these dramatic financial challenges, the Utility has continued its effort to reduce expenses as much as possible in anticipation of the substantial work ahead. However, even ongoing budget scrubbing won't be enough to right the ship. So, it's time to devise a new and enduring business model and rate structure that reflects the permanent advance of conservation while still funding the utility at a level that will keep high

quality water services to all our customers. Therefore, I've directed the Water Utility to develop a process to seek input in order to develop alternatives that Council could consider to ensure that AWU is on sound financial footing now and in the future.

Austin is not alone in these efforts to reshape its rates and business model as many other utilities in Texas and across the nation are facing similar challenges. Here locally, Cedar Park recently enacted water rate increases tied to its implementation of one day per week watering. Similarly, Dallas has implemented a rate strategy linking increased rates to declining reservoir levels and Fort Worth Water recently experienced a downgrade in its bond ratings as a result of declining water use and associated revenue losses.

**Joint Financial Subcommittee** - One group of citizens has the background and knowledge that will be invaluable in this process. As you recall, the Joint Financial Subcommittee (JFS), with members from the Water and Waste Water Commission, Resource Management Commission, and the Impact Fee Advisory Commission, provided the Utility and Council with valuable guidance and recommendations on managing revenue volatility and financial risks in 2011-12. They already know the Water Utility's challenges...in fact they began addressing the rate structure challenges during their last efforts by recommending the creation of a revenue stability reserve fund. So, they would start this new task with a knowledge foundation allowing them to start reviewing paths forward immediately. With that in mind, I've directed the Utility to re-launch this task force to seek input on strategies to manage the financial impacts associated with the prolonged drought.

**Next Steps** - In order to have recommendations for the upcoming budget process, we are planning to complete the work with the JFS by the end of May. In addition to reconvening the JFS, we have requested that the Water and Wastewater Commission begin their budget review process earlier than normal to assist the Utility in preparing the FY 2014/15 budget. We expect that a substantive business model change would warrant a separate Council Work Session going forward so we will be working to schedule time for the Council to digest and discuss potential alternatives in June.

If you have any questions, please feel free to contact me.

**XC:** Mike McDonald, Deputy City Manager  
Robert D. Goode, Assistant City Manager  
Greg Meszaros, Austin Water Utility Director