

FINANCIAL CONCEPTS AND APPLICATIONS, INC.

**3907 RED RIVER
AUSTIN, TEXAS 78751**

(512) 458-4644

BHFairchild@gmail.com

April 11, 2022

Ms. Ginger Faught
Deputy City Administrator
City of Dripping Springs
511 Mercer Street
Dripping Springs, Texas 78620

Dear Ginger:

You requested that we prepare a study developing rates for water service that the City of Dripping Springs is scheduled to begin providing in 2022. Rates for water service are customarily based on an analysis of the utility's cost of providing service, similar to the methodology used to establish the rates Dripping Springs charges customers for wastewater service. A cost-of-service study is based on historical or budgeted data that reflects representative levels of the operating expenses, capital costs, and customer usage that are expected to prevail when the rates will be in effect.

For most water systems, operating expenses and capital costs are known historically or can be reasonably estimated, and the number of customers and their usage are measurable and relatively stable. However, because the Dripping Springs water system is new and developing, it is difficult to determine accurately the operating and capital costs required to operate the system, and even more difficult to estimate the number and usage of customers that will be served. As a result, performing a traditional cost-of-service study to calculate rates for the Dripping Spring water system is problematic, with there being no assurance that any rates will reflect the cost of providing service and produce revenues reasonably expected to recover these costs.

An alternative to a cost-of-service study is to set initial rates for a new utility based on those charged by neighboring utilities. The rates that similarly situated utilities charge are expected to be generally reflective of the cost of providing service in the area and can be viewed as a competitive and fair price for water service. Further, setting initial rates based on those charged by neighboring utilities provides an objective basis for initial rates until the Dripping Springs water system becomes sufficiently established and mature that information is available to allow a meaningful cost-of-service study to be performed.

Ms. Ginger Faught
April 11, 2022
Page Two

A second consideration in setting the rates to be charged by the Dripping Springs water system is whether to differentiate between customers located inside and outside the city limits. When a city-owned utility serves outside-city customers, it takes on additional risks and responsibilities in providing service. This burden is often accounted for by charging outside-city customers higher rates, which are determined based on differences in the cost of providing service or an amount judged reasonable. For example, the rates of the cities of Buda, Kyle, and Johnson City are approximately 30, 35, and 50 percent higher for customers located outside their city limits than within. Because meaningful cost data for the Dripping Springs water system do not yet exist, any inside/outside city rate differential must necessarily be based on other factors.

The most immediate neighboring utility to the Dripping Springs water system is the Dripping Springs Water Supply Corporation. DSWSC's current water rates consist of a fixed monthly charge of \$35.00 plus volumetric charges that increase in blocks as a customer's monthly usage rises. This rate structure is intended to encourage water conservation and is typical of most water utilities' rate design, although the blocks and rates are specific to each utility. In Attachment A, DSWSC's schedule of rates is displayed in the first column, with rates calculated assuming a 20 percent rate differential for outside-city customers being shown in the second column.

Attachment B is a graph that compares typical monthly bills based DSWSC's rates for inside and outside customers with the monthly bills of other nearby communities assuming monthly water usage of 10,000 gallons. As can be seen there, using DSWSC's rates as the basis for initial rates for the Dripping Springs water system would result in monthly bills that generally compare favorably with those of nearby communities.

If I can answer any questions or provide additional information, please do not hesitate to contact me.

Sincerely,

Bruce H. Fairchild

Attachments